CALIFORNIA STATE UNIVERSITY
FULLERTON
MIHAYLO COLLEGE
OF BUSINESS AND ECONOMICS

Economic Outlook and Forecasts:
The Nation, Southern California
and Orange County

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2016 ECONOMIC FORECAST

Woods Center for
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Research Reports,
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Southern California Leading
Economic Indicator

Adrian R. Fleissig, Ph.D.

How Happy Are People in
Orange County?

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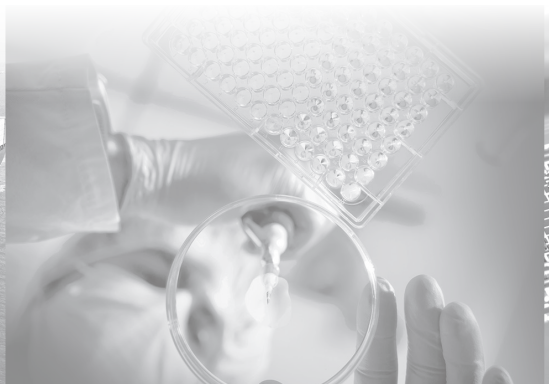
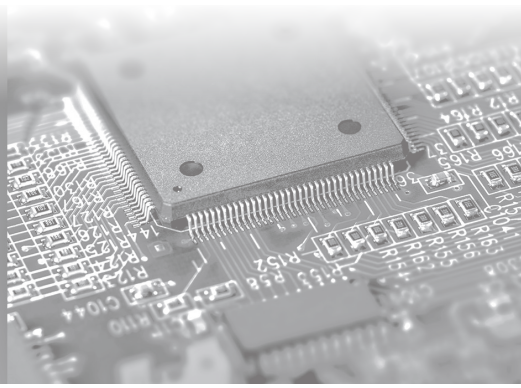
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NEITHER HEAVENLY NOR HELLISH, THE LAST SIX YEARS RESEMBLE MORE TO PURGATORY — A STATE WHERE THE EXCESSES OF THE PRE-CRISIS WORLD AND THE HAVOC OF THE GREAT RECESSION HAVE COME TO BE EXPUNGED AND EXPIATED.



2016: WILL THE LONG SLOG PERSIST?

ECONOMIC OUTLOOK AND FORECASTS:

The Nation, Southern California and Orange County

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U.S. ECONOMIC OUTLOOK AND FORECASTS

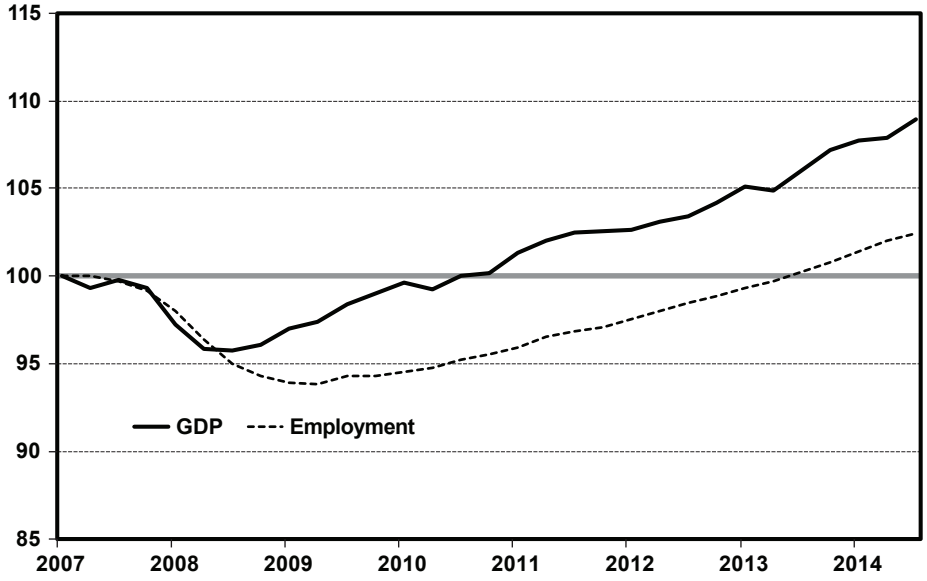
Welcome to Purgatory

"Go to Heaven for the climate, Hell for the company," Mark Twain once famously quipped. Very few would argue that the economic climate over the past six years has been anywhere close to heavenly. And while the state of affairs has not been as dire as the infernal experience of the Great Recession, the ever-expanding set of countries with sluggish growth and downwardly revised expectations lends something to the notion that a larger company has inched slightly closer to the doors of Hades over the past year than the gates of paradise.

Lest the above description appears too morose (and it is), let's be honest up front about our own view on the global economy: neither heavenly nor hellish, the last six years resemble more to purgatory — a state where the excesses of the pre-crisis world and the havoc of the Great Recession have come to be expunged and expiated.

Indeed, the six-year-old recovery has been one of the longest in post-war record: it is the fifth longest since 1900. It has outlasted 10% of marriages; it pre-dates the invention of the iPad by almost one year. Undoubtedly much progress has been made during this time: household debt levels are now in the best shape in over 30 years; employment is up by 12 million compared to the depth of the crisis and up by 4 million relative to pre-recession levels; unemployment has fallen near pre-recession lows; output has expanded by a total of 13.8% (8.8% since 2007); the housing market has bounced back vigorously after the collapse; corporate profits as share of GDP have set record levels; and the financial sector is now much better capitalized, more stress-tested, and less vulnerable than prior to the crisis (Figure 1). And the list goes on.

FIGURE 1
Real GDP and Employment Growth
(Index level, December 2007=100)



Nonetheless, the healing period — the sojourn in purgatory — has been longer and more painful than what most predicted. What was a recession (albeit a deep one) has turned into everyone's nightmare: perpetual sclerotic growth. GDP growth has never exceeded 2.5% (not to mention the 3%-3.5% historical trend-growth) over the past six years, often undershooting it. After an annual revision of the BEA numbers, it was revealed that growth from 2010-2014 averaged a meager 2% per year, down from 2.3% estimated earlier. Potential GDP — the level of output consistent with full employment — is currently a staggering $1.5 trillion short of its 2007 estimate. Potential trend growth is also estimated much lower — from a historical 3% annualized pace to a current 2% (and even lower based on Fed estimates). Productivity is stuck in a low gear and the labor force participation rate has collapsed by 3.5 percentage points since the start of the recession. These figures are even more depressing when contrasted with the unprecedented measures taken by authorities since the crisis: the Fed has injected nearly $4 trillion in liquidity while the various government programs have provided $2.5 trillion in additional support. Interest rates have remained at rock-bottom levels for a full seven years now.

Our view is that the US economy is strong and mature enough to weather the current headwinds and muster a stronger showing over the next two years that outperforms the past six.

The frail gait of the expansion has left the economy vulnerable to all sorts of shocks. Harsh winters have produced icy first quarters over the past two years. A West Coast labor port dispute was enough to cast a pall on trade, production, and sentiment during the first quarter of this year. The collapse in oil prices produced a sharp drop in energy-sector investment while a stronger dollar caused a drag on exports. Global events have snuffed the spark out of the equity markets, spiking volatility and concerns about growth. Add to this the "longest drum roll in its 102 year history" (according to some) — the much awaited commencement of the rate hiking cycle by the Fed — and the picture we are left with is of an economy that is hobbling along, skirting potholes and girding up against headwinds.

Our view is that the US economy is strong and mature enough to weather the current headwinds and muster a stronger showing over the next two years that outperforms the past six. We expect the expansion to strengthen further with growth nudging up higher from an average annual pace of 2% to 2.4%-2.6%. This may not seem much (and it is certainly below the 3%-3.5% historical trend growth), but it is an improvement over the mediocre performance of the last half decade. The escape from purgatory will land us in a more scaled-down version of nirvana than we had hoped for, but this is still slightly better news than what we have been accustomed to so far.

Having said that, our forecasts are less cheery and more cautious than the consensus.

The biggest reason for a brighter prospect in the near term is consumer spending: U.S. consumers seem to have finally shaken off the doldrums of the recession buoyed by an improving labor market, better home valuations, and lower gasoline prices. Motor vehicle sales soared to an annualized pace of 17.7 million in August (highest rate since 2005) and though some pull back is expected, we do anticipate this component of spending to remain strong. Wages and income are also expected to firm up — albeit slowly — as the labor market tightens further, supporting spending. Homebuilding should also contribute positively to growth, as momentum builds further in response to a shortage in inventory and higher prices. Importantly, commercial construction is also expected to ramp up, with the recovery broadening to long-suffering corners of the market, such as retail and office space.

Having said that, our forecasts are less cheery and more cautious than the consensus. This is not a novelty as our projections have tended to be below-consensus during the past few years, which has proven more right than wrong in an environment where growth has often disappointed on the downside. There are a number of risks that, in our view, will weigh on growth over the next few years and make for more dour predictions.

First, the Federal Reserve is widely expected to raise interest rates for the first time in nine years — a momentous event with wide-ranging implications for the US and the global economy. Both the timing and the pace of policy firming matter, and while we expect the Fed to proceed cautiously — they have almost fallen over backwards to promise just a 'pinprick' — we cannot rule out the probability of heightened uncertainty and excessive volatility in financial markets, which may dislocate markets and disrupt financial stability. Second, the down-drift in global growth due to a greater-than-expected slowdown in China will likely have a larger impact on US growth than what the current consensus thinking anticipates. Add to that the woes of emerging market economies, where the plunge in commodity prices and capital outflows due to a stronger dollar have combined for powerful headwinds, and the global environment is at its most challenging point since the end of the Great Recession. Trade will certainly be a drag on growth during the forecast horizon.

A third factor restraining growth is the fate of corporate profits: the first two quarters of this year registered declines on year-ago levels due to a softer global outlook and a stronger dollar. The manufacturing sector has stumbled along during the first half of the year, and while we expect moderate improvements over the next few quarters, the outlook will be challenging. The deep plunge in oil prices has decimated capital investment in the energy sector, which fuelled US growth in the first half of the recovery. All this combined with low productivity gains means that the outlook for business investments (particularly in Equipment & Software) will be soft going forward.

US Real GDP: Downwardly Revised

Here we go again: another year, another revision. In their latest annual update, the Bureau of Economic Analysis (BEA) revealed (yet again) that the growth rate of the recovery was more anemic than previously estimated. It turns out the economy had managed to eke out a measly average annual growth of 2% over the past five years, instead of the (equally depressing) 2.3% reported earlier. 2012 growth was revised down by 0.1%, but 2013 took first prize, having been downgraded from 2.4% to a paltry 1.5%. This does not come as a surprise: the story of this recovery has been one of dashed expectations where initial estimates have almost always crashed down to earth to meet a more somber reality.

The economy had managed to eke out a measly average annual growth of 2% over the past five years, instead of the (equally depressing) 2.3% reported earlier.

It did not help that 2015 (much like the previous one) started with a frosty first quarter, which cast a pall on the rest of the year: real GDP barely grew in Q1 2015, crawling at an annualized pace of 0.6%. Much of the slowdown was due to one-off events: weaker-than-expected sales, lower investments in the energy sector due to the slump in crude prices, a worsening trade balance due to the dollar strength, West Coast port disruptions and slowdown, and the ever-present harsh winter. However, these disruptions raise concerns about the strength of the recovery: after all, if chilly winters and short-term labor disputes can grind activity to a near-halt, it means that this recovery is more fragile and more vulnerable to shocks than what most expect.

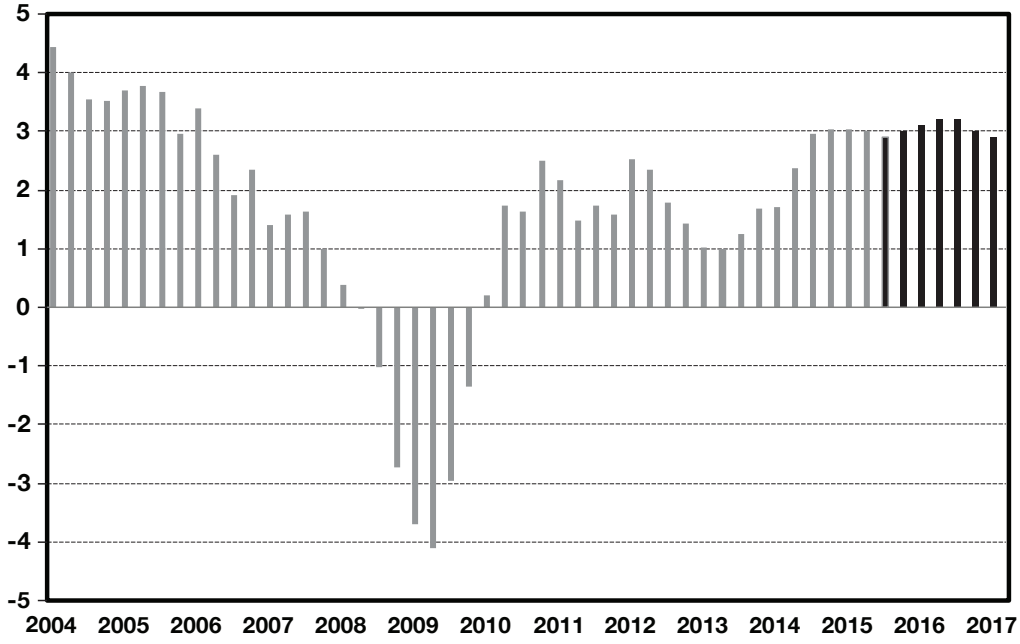
Having said that, we expect improvements for the balance of this year and the next. In fact, the second quarter was quite encouraging, with growth rebounding to 3.9%, buoyed by a strong pick-up in consumption spending and two quarters of back-to-back surges in inventories. The first — the rise in consumer spending — is unquestionably positive, and we expect consumers to continue to carry out the heavy lifting over the next two years. More importantly, the breadth of spending is perhaps as heartening as the pace: spending on services — a long-suffering component since the start of recession — grew by 2.7% in Q2 2015, spending on durables by 8% and non-durables by a healthy 4.6%.

The outlook seems brighter when stripping away the temporary noise from the data (such as inventory cycle and international trade): real final sales (a more direct measure of the underlying momentum of the economy) are expected to grow at a more robust above-3% rate over the next couple of years.

The second component — a rise in inventories — will weigh on growth over the second half of the year. Inventories rose by more than twice their average value over the first two quarters of the year: some correction is expected and will likely come at the expense of the third and fourth quarters of the year. Business and investment spending are expected to be lukewarm with expenditures on Structures and Intellectual Property picking up steam, while investment in Equipment & Software totters along. Investment in residential construction, particularly single-family home constructions, is expected to grow, while international trade will be a net drag as the dollar strength and weak growth abroad will likely lop off a sizable chunk of US GDP growth.

So we are left with a mixed bag: an uneven recovery powered by consumers, homebuilding, and commercial construction but held back by the production side, the inventory cycle, and a very challenging global outlook. We expect the second half of the year to underperform the second quarter, largely because of inventory corrections and international trade effects. Real GDP should expand a hair more briskly over the forecast horizon, growing by 2.4% this year, 2.6% in 2016, and 2.5% in 2017. The outlook seems brighter when stripping away the temporary noise from the data (such as inventory cycle and international trade): real final sales (a more direct measure of the underlying momentum of the economy) are expected to grow at a more robust above-3% rate over the next couple of years (Figure 2).

FIGURE 2
Real Final Sales are More Solid than RGDP Numbers
(Real Final Sales, year-over-year percent change)



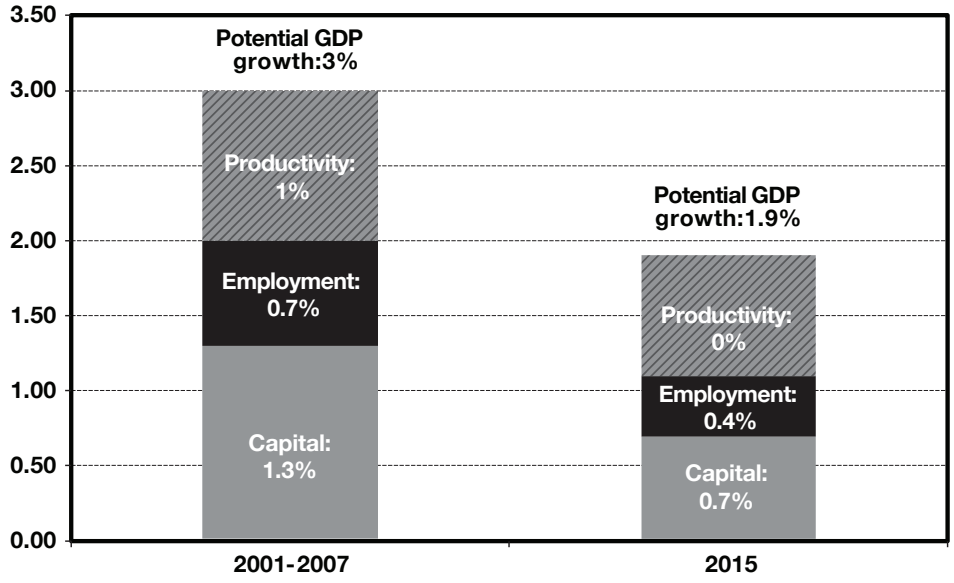
Reduced Potential: GDP Potential Growth After the Crisis

As we have argued in the past, one of the most worrisome legacies of the recession and the snail-paced recovery is the likely damage to potential output. Indeed, the Congressional Budget Office (CBO) has gotten into a habit of issuing increasingly troubling reports on that front over the past six years: potential output growth in the US — once humming along at 3%-3.5% pace — seems to have shifted permanently into lower gear, growing at a feeble 2% at the moment and averaging a more depressing 1.8% since the end of the recession. Not to be outdone, numbers inadvertently released from the Federal Reserve seem to suggest that the Fed has also recently slashed US potential output growth down to a meager 1.75%.

Potential output is now a full $1.1 trillion below what in 2007 was thought its potential would be in 2015. Actual real GDP paints an even gloomier picture: it is now a full $1.5 trillion below where we should be had the crisis never happened. This matters greatly. A country's living standards depend on its (supply-driven) growth potential, which, in turn, is a function of three factors: the size of the labor force, the size of capital investments, and how productive the two inputs (labor and capital) are. And before we hastily ascribe this downdraft to demographic factors and an ageing demographic, let's not forget that the graying of the labor force did not materialize unexpectedly and overnight over the past six years. The CBO has sophisticated demographic models that predict this sort of thing: they knew back in 2007 that an entire generation of baby boomers was going to retire over the next decade and a half, yet potential output estimates were much more upbeat when compared to more recent years.

This means that the Great Recession has inflicted some permanent scars on the economy's long-run potential. The two main culprits for this are a persistent shortfall in capital investment and a sizable reduction in potential employment growth, led primarily by a drop in the labor force participation rate. From 2001-2007, potential output growth in the US averaged around 3%, of which capital investment growth made up 1.3 percentage points, potential employment growth contributed 0.7 percentage point, and growth in total factor productivity added an additional 1 percentage point (Figure 3). Our estimates indicate that the long-run potential growth of the US economy post crisis has shrunk to roughly 1.9%, with capital growth contributing 0.7 percentage points, employment growth 0.4 percentage points, and total factor productivity an additional 0.8 percentage points.

FIGURE 3
On the Downslide: Potential GDP Growth
(percentage points, annual rates)



Our view is that US potential GDP, while growing at a faster pace over the forecast horizon than during the past six years, will likely settle at permanently lower trend of around 2%-2.25%. This is partly due to ageing demographics and partly due to the crisis legacies: a shortfall in capital investment (which will take much longer to unwind and catch up) and a decline in working age labor force participation (which is unlikely to reverse in the near term).

Our view is that US potential GDP, while growing at a faster pace over the forecast horizon than during the past six years, will likely settle at permanently lower trend of around 2%-2.25%.

Bright Spots

Powering Growth: US Consumers

Our outlook for this year and the next would be unquestionably more dour if it were not for the US consumer.

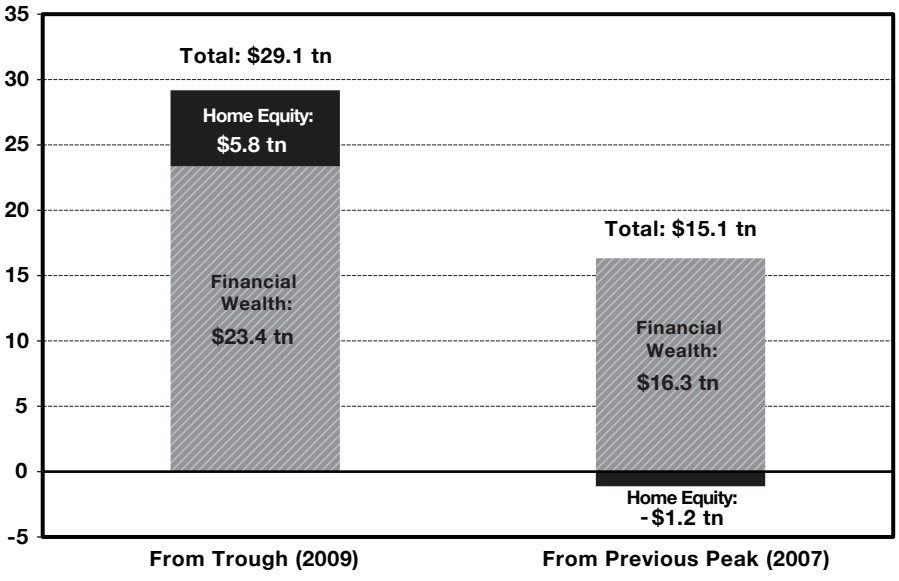
Our outlook for this year and the next would be unquestionably more dour if it were not for the US consumer. Indeed, there are plenty of reasons to be optimistic on this front: consumer spending grew by a brisk 2.7% in 2014, outpacing the rate of the past five years. Even a chilly winter did not dent spending by as much as one would have expected: real consumption growth was 1.8% in the first quarter of this year, outperforming the broader economy, which grew by a paltry 0.6% during this period. Spending was encouragingly more robust in the second quarter, growing by a solid 3.6% annualized pace.

Improvements are broad based: spending on durable goods rose by a healthy 8% in Q2 2015 while expenditures on non-durables increased by 4.3% — the third fastest rate since the start of the recovery. More importantly, spending on services — a long-languishing component of consumption — grew by 2.7% in the second quarter, far outpacing the 1.6% tepid pace averaged during the recovery. Indeed, consumer spending accounted for nearly two-thirds of US GDP growth in the second quarter, half of which was due to more robust spending on services and half to spending in durable and non-durable goods.

There are reasons to expect a stronger consumer spending over the forecast horizon. Payroll jobs have expanded at a confident pace of around 230,000 jobs per month over the past year, unemployment has fallen precipitously to levels consistent with full employment, and gas prices have slumped by 30%. Consumer confidence has taken a hit since mid-summer due to a gloomier global outlook, financial market volatility, and geopolitical risks, but even with the most recent retreat, consumer sentiment is currently standing at cycle-highs and only inches away from pre-crisis levels.

More importantly, consumer finances are in the best shape since the start of the recession. Household net worth is now $15 trillion higher than in 2007 and a staggering $29.2 trillion above levels recorded during the recession. Household wealth is also up in real terms, currently standing at $10 trillion above pre-crisis levels, setting record-highs relative to real GDP as of the last quarter. Most of this is due to the spectacular gains in equity markets: financial wealth is now $16.3 trillion above pre-2007 levels and a more impressive $23.4 trillion above recession trough. Recent turbulence in global financial markets will likely knock off some of these gains in the third quarter, but the drawdown is still relatively small compared to the spectacular gains of the six-year bull run in equities. More importantly, home equity wealth has managed to claw back a sizable chunk of the collapse it suffered during the recession: of the roughly $7 trillion losses in homeowner equity, roughly $5.8 trillion has been recovered. This is undoubtedly good news as home equity gains are broader based and tend to boost spending more than improvement in financial wealth, which normally accrues to a smaller segment of the population (Figure 4).

FIGURE 4
Up and Away: Household Net Worth Above Previous Peak
(changes in HH financial and home equity wealth; trillions of dollars)

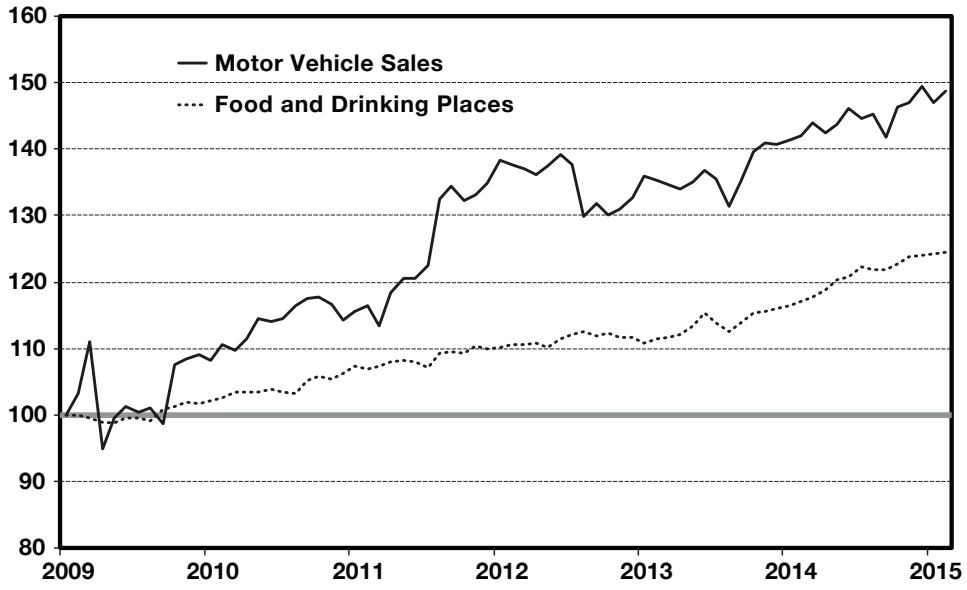


Consumption habits also seem to have changed since the end of the Great Recession. For example, while real retail sales rose by 18% since peak-crisis, they are only up by 11% when Motor Vehicle sales and Food Services & Drinking Places are excluded. In fact, spending in Motor Vehicles and Food Services and Drinking Places have outperformed by far any other category during the six-year recovery, growing by 48% and 24%, respectively, during this period (Figure 5). Motor Vehicle sales have been quite strong during this period, running at an annualized pace of 16.4 million in 2014 and a record-high 17 million this year.

We expect consumer spending to expand robustly over the forecast horizon, especially since there still appears to be quite a bit of pent-up demand, which was largely subdued during the sluggish recovery but should pick up as consumer's financial conditions improve. For example, compared to other recessions, consumption spending is now still short by around $800 billion. Spending on durables is running above trend, and we don't foresee it adding much more over the next few quarters given the sizable pick-up in auto sales over the past two years. But spending on Household Services is still woefully below post-recession average pace by around $640 billion. The lion's share of this shortfall comes from under-spending in Housing and Utilities ($200 billion below-trend) and Financial Services ($170 billion below trend). We expect these long-suffering categories to pick up more briskly over the next few years as the housing market stages a stronger comeback, the labor market continues to improve, and incomes rise. Consumption spending should grow by 2.9% in 2015, 3.0% in 2016, and by 2.6% in 2017.

We expect consumer spending to expand robustly over the forecast horizon.

FIGURE 5
A Change in Consumer Behavior: More Cars and More Drinks
(retail sale spending, Motore Vehicle and Food/Drinking Places, Index, 2009=100)



Labor Markets: Tighter than You Think

There is no way to spin the latest September jobs report: however one views the data, the picture emerging is an ugly one. US employment rolls grew by a paltry 142,000 jobs in September, far below the consensus estimate of around 200,000. There was worse news: the rosier job numbers for July and August were revised downwards, the labor force contracted by 350,000 jobs and wage growth was largely flat. The pace of monthly job formation in 2015 is 198,000, down from the white-hot rate of 260,000 recorded in 2014. The downshift is even more pronounced over the past few months when the pace of job formation has averaged a more depressing 167,000 jobs per month. If the rest of the year continues this way, 2015 would be the first year since the recovery began when the pace of job formation has come below the previous year.

Still the labor market has come a long way and has improved meaningfully since the dark days of the recession. Nonfarm payrolls are now 12.7 million higher when compared to their 2010 values. In fact, employment rolls are now 4 million above their pre-recession peak. Other labor market indicators are equally inspiring: the unemployment rate is now down to 5.1% (almost to pre-crisis levels); the number of long-term unemployed has declined to 2.1 million from a recession high of 6.8 million

The labor market has come a long way and has improved meaningfully since the dark days of the recession. Nonfarm payrolls are now 12.7 million higher when compared to their 2010 values.

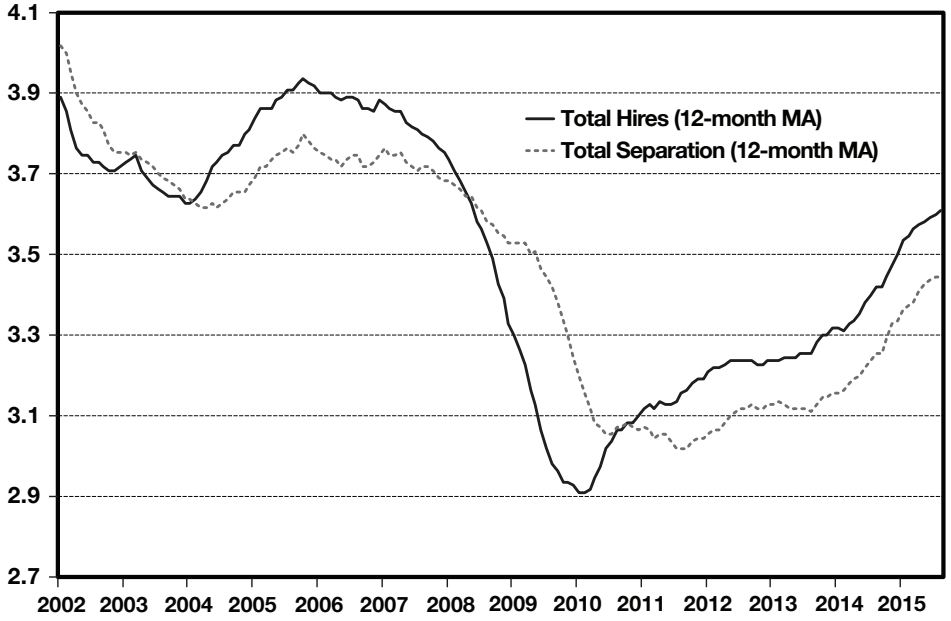
Some aspects of the labor markets have not fared as well. In particular, labor utilization, which includes the supply-side of the market (things like difficulty in finding jobs, working part-time for economic reasons, marginally attached to the labor force), is dismally below its 2007 levels.

(historical average is around 1.4 million); and the broader measure of unemployment, which includes the discouraged and the marginally attached workers, has dropped to 10%, down from 17% at the height of the crisis (historical average is 8.7%). Importantly, the last year or so has recorded a sizable pick-up in the mix of full-time employment, which languished during the earlier part of the recovery as part-time jobs were created at a dizzying pace. In fact, full-time employment finally surpassed its pre-recession peak two months ago and is currently running 270,000 jobs higher than in 2007. This augurs well for the economy considering that just a year ago the level of full-time employment was a jaw-dropping 2.5 million below its pre-crisis level.

But other aspects of the labor markets have not fared as well. In particular, labor utilization, which includes the supply-side of the market (things like difficulty in finding jobs, working part-time for economic reasons, marginally attached to the labor force), is dismally below its 2007 levels. The employment-to-population ratio has edged up only by 0.9 percentage point from the height of the recession and currently stands 3.7% below its historical average. Equally disturbing, the labor force participation rate has collapsed since the recession and is currently at levels last seen in 1977.

In addition, the job market appears to have lost some of its luster — its dynamism — since the recession: labor market "churn" — the normal business of hiring, quitting, firing, and retiring — appears to have settled at a lower gear (Figure 6). The hires and separations rate, though improved from recession lows, are distinctly below their 2000-2007 pace. And even though job openings currently stand at record-levels (since 2000 when BLS began collecting the Job Opening and Labor Marker Turnover — JOLTS — data), the "quits" rate continues to languish. Some loss of dynamism is certainly expected within the context of an ageing population. Some is attributed to the fact that fact that fewer new businesses — a large source of job growth — are being born. Companies are also exerting more caution when filling new positions in light of a global slowdown and an uncertain revenue environment. And employees feel unsure about the strength of the labor market, so they continue to hold on to the current job rather than quit in order to look for other prospects that better match their skills and aspirations.

FIGURE 6
Losing Some Oomph: Labor Markets Less Dynamic
(total hires and separations rate, 12-month moving average)

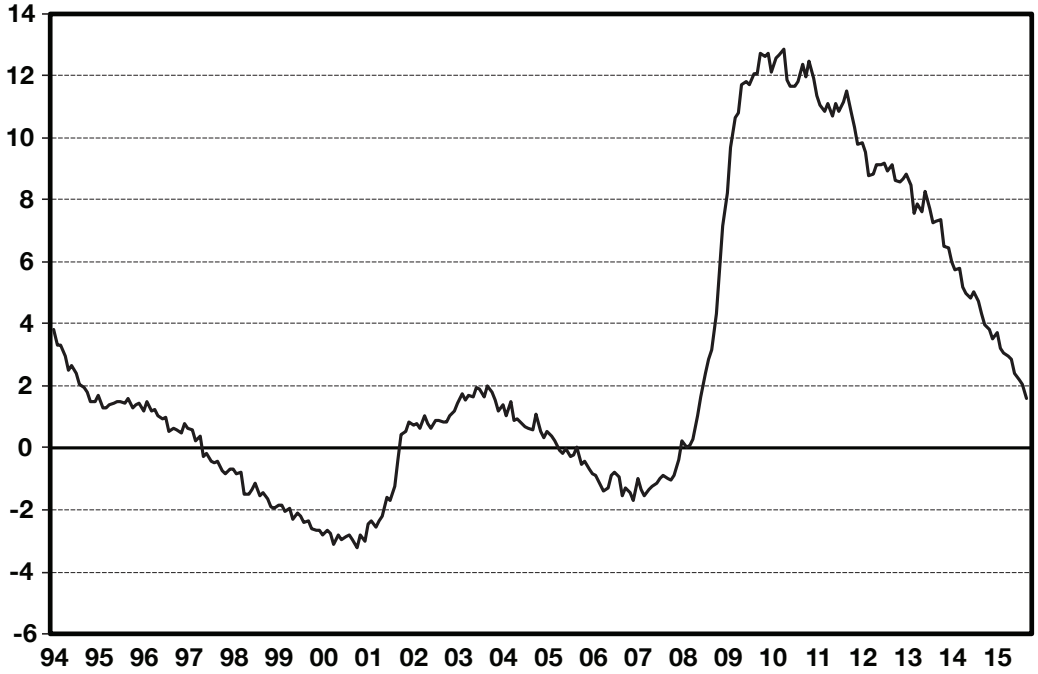


It is tempting to blame some of the labor market woes on adverse demographic trends: after all, an ageing population is expected to produce a less dynamic employment market, with fewer number of new businesses being created, less churn, and a labor force that expands at an increasingly slower rate. But labor market ills are also quite pronounced for the most vital segment of the population: prime-aged workers — those between 25-54 years old. In fact, perhaps the most disturbing trend since the onset of recession is the changing landscape in employment and labor force participation rates among the prime-age workers. If the employment-to-population ratio for this age cohort had remained at the same level as its 2000-2007 average, there should now be 2.8 million more employed prime-aged workers than there currently are. This is an improvement over the 6 million employment gap recorded in 2009, but the shortfall appears to be persistent and long lasting (the shortfall improved only marginally over the past year, from 3.1 million to a current 2.8 million). More concerning is the yawning gap in the labor force: adjusted for population, the labor force among prime-aged workers is now 3.1 million below where it should have been had the labor participation rate equaled its 2000-2007 average. Worse still, the gap between the estimated and the actual labor force for this age-cohort has widened in every year since 2008, which means that improvements in the labor market have done very little to alter this adverse trend.

We estimate that the labor market slack is much smaller than what most economists project. Adding up the marginally attached workers, those part time for economic reasons, and the unemployed (who are actively seeking a job), the labor market slack appears to be roughly 1% (1.6 million).

Indeed, the belief of an imminent reversal of this trend — that labor force participation rates would swell up more confidently once the labor market improves — has shaped much of the thinking of many economists (including the Fed) over the past few years. We estimate that the labor market slack is much smaller than what most economists project. Adding up the marginally attached workers, those part time for economic reasons, and the unemployed (who are actively seeking a job), the labor market slack appears to be roughly 1% (1.6 million) (Figure 7).

FIGURE 7
Labor Market Slack is Smaller than You Think
(labor underutilization, millions of people)



Going forward, we expect the labor market to continue to expand, albeit at a perceptibly more moderate rate than in 2014. The pace of job formation is expected to average 195,000 jobs per month in 2015 and around 180,000 in 2016.

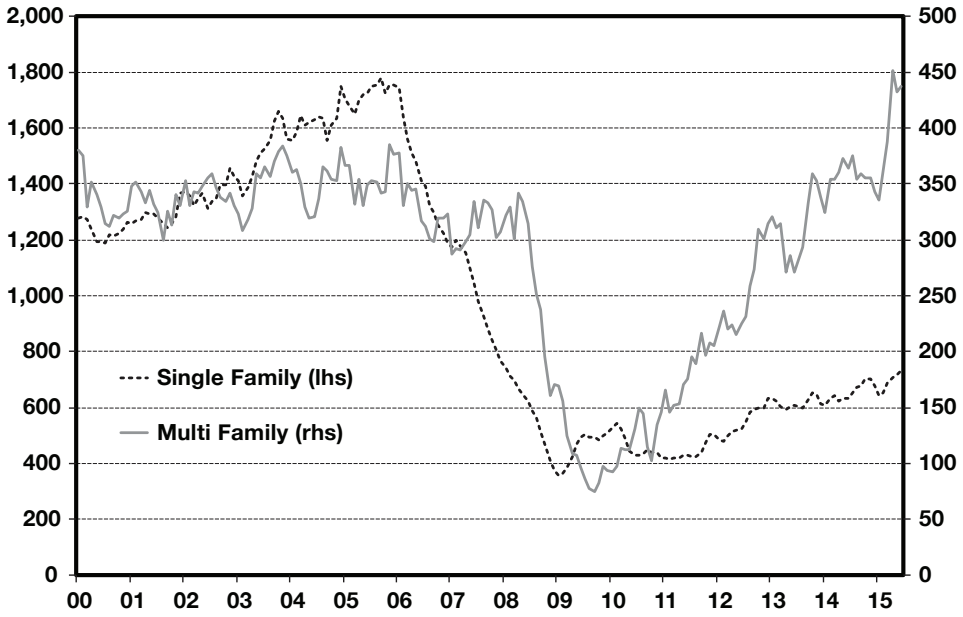
There is no doubt that the further away one gets from the doldrums of the global economy, the brighter things look. Housing is unquestionably as local as it gets: its outlook is largely driven from underlying growth in the local economy, the strength of the job market, the pace of income growth, and the rate of household formation.

Housing Outlook: Brighter than Most Expect

There is no doubt that the further away one gets from the doldrums of the global economy, the brighter things look. Housing is unquestionably as local as it gets: its outlook is largely driven from underlying growth in the local economy, the strength of the job market, the pace of income growth, and the rate of household formation. As we have argued so far, job and income growth has improved materially over the last year. More importantly, 2015 has finally brought some much awaited good news on the household formation side: over this year, the number of new households has grown by 1.7 million — the fastest pace in a decade. And though much of this increase has shown up in the rental market, where demand for apartments and multifamily housing has exploded, there are imminent signs that this is about to change and the demand for housing should pick up. The foreclosure rate fell 0.5 percentage points over the past year while mortgage delinquency rates have continued to trend lower. Existing home sales are currently running at a 5.2 million annualized pace, up from an average pace of 4.9 million recorded in 2014. Homebuilder sentiment is now at the highest level since October 2005.

It should be noted, however, that these improvements come on the heels of what has been a most disappointing recovery in the housing sector. The long-awaited rebound has met with more than a few hurdles over the past five years, and by comparison, things are still moving at a nerve-wracking slow pace. Total housing starts have averaged roughly around 1.1 million this year — up from the 1 million pace of the previous year, but still below its long-run trend (of around 1.5 million). Even so, most of the increase in housing starts came from multifamily homes, which are currently running at the same pace as in the housing boom of the past decade (Figure 8). Single-family starts have also risen from the abyss of the recession, but at a 700,000 annual pace, they are roughly half the levels that prevailed from 1995-2003 (pre-boom). The much anticipated "hand-off" from investors to traditional home buyers has taken much longer than most anticipated due to a slew of factors: tight borrowing standards, tepid wage growth, and less demand for trade-up purchases as record numbers of credit-worthy homeowners chose to stay put in their homes and refinance at the lowest rates in a generation. As a result, home-price appreciation, which rose at an escalated pace in late 2012 and in 2013, thanks in large part to an investor-driven frenzy, has now abated and settled at a much more muted 4%-5% pace.

FIGURE 8
Lots of Pent-Up Demand: Consumption Spending Below Trend
(percent deviation from historical trend)



Our outlook for housing is quite upbeat over the forecast horizon chiefly because the main factors that have so far restrained a meaningful comeback are receding. First, household formation is on the rise: an estimated 12 million households are expected to be formed over the next decade as millennials — a larger age-cohort than even the baby-boomers — come of age, get a job, get married, and form families. Second (and related), there is "pent-up" demand for household formation, which collapsed during the crisis and has yet to catch-up: if the number of adults per household is kept equal to its historical rate, we find that there are now roughly 2 million households missing in the economy. Third, continued job and income growth should boost demand for housing over the next few years, providing first-time home buyers with a much-needed dose of confidence. Fourth, qualifying for a mortgage should also be a bit easier than in recent past: FHA lowered mortgage insurance premiums by half a percentage point late last year and FHFA decided to allow Fannie Mae and Freddie Mac to purchase certain mortgage loans with only 3% down payment. We expect housing starts to average around 1.15 million this year, and 1.29 million in 2016.

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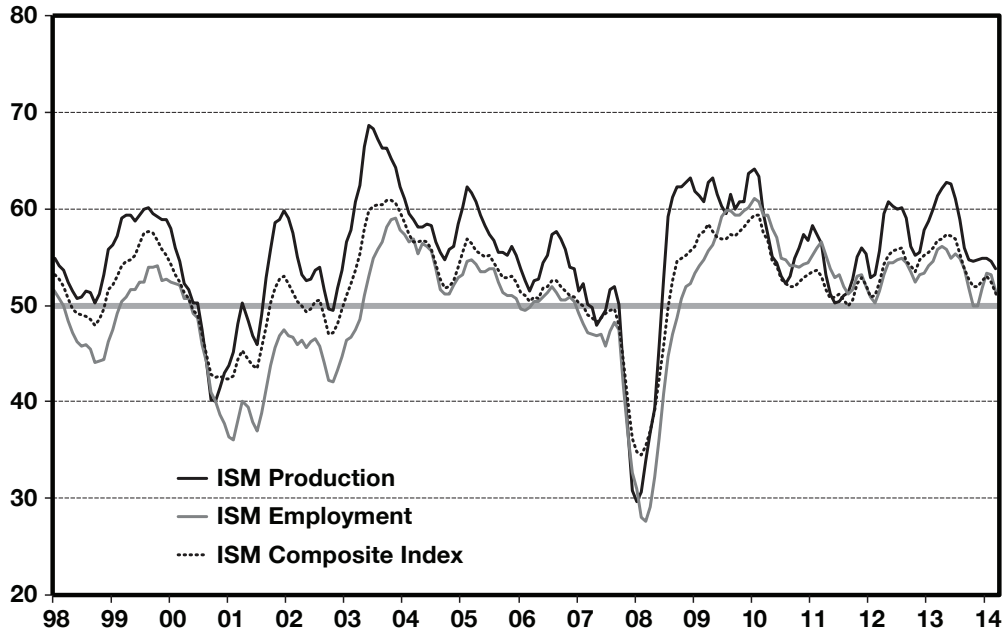
Challenging ...

On the Gloomy Side: Outlook for Businesses

One thing has become abundantly clear over the course of this year: the recovery has split into a two-tiered movement with the consumer side trotting at a springier step while the production side hobbles along. To be perfectly frank, much as we cautioned in our April report, production has been in a world of hurt for almost one year now. Dollar strength and a weaker global growth have pummeled the manufacturing sector: production has slowed to a crawl, growing by a mere 1.7% on an annual basis — down sharply from a growth rate of 4% recorded late in 2014. A raft of other data are just as ominous: durable goods orders have collapsed over the past few months and are currently down 9% on a year-over-year basis, while core capital goods orders (non-defense capital goods excluding aircraft) fell by 5.2%. The Institute of Supply Management (ISM) indices are barely hanging above expansion territory: ISM Manufacturing Production is currently at 51.8, ISM Employment is at 50.5, while the composite index is at 50.2 (a number below 50 denotes a contraction) (Figure 9). Capacity utilization, which had edged up higher towards its long-run average level of around 80, has taken a turn for the worse over the past few months. Worse, the index was revised downwards by a full 1.4 percentage points following the annual revision, which revealed a less robust expansion over the past three years.

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FIGURE 9
Manufacturing in a World of Hurt: ISM Indices Have Collapsed
(ISM Indices, level)



Our outlook for business investments is quite modest. In the face of continued dollar strength, weak global growth, soft commodity prices, and a challenging environment for corporate profits, we expect firms to proceed rather cautiously with their investment plans.

To add more salt to the wound, the collapse of oil prices has taken the wind out of investments and production in the mining and energy sectors. The mining sector has contributed an average of 0.6 percentage points to business fixed investments since the start of the recovery. Some of this came in the form of nonresidential fixed investments, which rose (in real terms) from $72 billion in 2009 to $137 billion in the last quarter of 2014. It has collapsed presently to a mere $90 billion. Some of the boost in investment came from investment in Equipment and Software: investment in Agriculture and Mining Machineries has been one of the most robust component of equipment investment during this recovery, growing from a share of 5% of investment outlays to 8%. Altogether, the energy sector has accounted for nearly one-fourth of the growth in business investment during the recovery cycle. With commodity and crop prices expected to languish at low levels over the forecast horizon, we anticipate investment in the energy sector to recover only slowly from its current depressed levels.

The shortfall in business investment is even more evident when compared to historical trend levels. Part of this is due to the historic collapse that business investments experienced during the crisis. Part of this is also a reflection of a longer-term trend that began at the turn of this century with firms investing a smaller fraction of their profits in capital investments. All told, the shortfall in business investments is now a staggering $770 billion below trend levels: investment in non-residential structures is $60 billion below trend, investment in Equipment and Software an additional $140 billion below trend, while Intellectual Property investments are running $20 billion below historical trend levels. Not surprisingly, the lion's share of the shortfall is in housing investment — worth $550 billion — following the epic collapse and the slow recovery in this sector.

Our outlook for business investments is quite modest. In the face of continued dollar strength, weak global growth, soft commodity prices, and a challenging environment for corporate profits, we expect firms to proceed rather cautiously with their investment plans. Domestic sectors, such as investment in construction for both residential and nonresidential structures and construction equipment, should offset some of the gloom from the energy and manufacturing sector. Overall, we expect nonresidential business investments to grow by 3.6% in 2015 and 4.8% in 2016.

Stalled: Wage and Productivity Growth

Two developments have continued plagued the recovery over the past couple of years and will likely weigh on the outlook: the lack of wage and productivity growth. Wage growth has averaged a pitiful 2% rate per year since 2010, a far cry from an average post-recession pace of roughly 4%. Productivity growth has also slowed down perceptibly over the past decade, save for a short-lived jump during the height of the crisis when employment rolls were slashed radically and firms were able to boost productivity with the remaining (shrunken) employment base.

There are a number of reasons why wage growth has been hard to come by in this cycle. Some of them are cyclical, while others structural. On the cyclical side, as argued earlier, despite continued employment gains, labor market slack — underutilized labor resources — continues to persist. The number of people employed part time for economic reasons is around 1.7 million above its historical average, with the number of the marginally attached and discouraged workers running around (a cumulative) 700,000 above trend. Low inflation rates have also tended to suppress wages as employers are less likely to compensate workers for cost-of-living adjustments when these costs are rising at a much more tepid pace.

On the structural side, the retirement of baby boomers, a sizable pick-up in part-time employment, and slower productivity growth all seem to have contributed to wage stagnation. Older workers do tend to get paid better than other age cohorts: as the baby boom generation got older over the past 30 years, median wages rose. However, this trend moderated appreciably over the last six years as this large cohort began retiring. The increase in part-time work is certainly another contributing factor of slower wage growth: faced with higher costs for employee benefits, employers have opted for more part-time hiring. It is also the case that an expanding number of employees are choosing part-time employment for non-economic reasons. Whatever the cause of expanded rolls of part-time employment, part-time workers receive only about 52% of the wages of full-time workers. Moreover, wage growth among this cohort has risen roughly by 0.9% annually, compared to the 3.8% rate for full-time workers.

Weak productivity growth has not helped. In fact, one could argue that tepid wage growth may, in part, reflect slow gains in productivity over the past few years: labor productivity grew at an annual pace of 0.5% over the past three years, far below its 2000-2007 rate of 2.7%. The same can be said about total factor productivity. This may be a reflection of an overall soft economic growth environment or a marked slowdown in business investments since the end of the recession. Either way, weak productivity gains will continue to place downward pressure on wages.

Our view is that both wages and productivity will remain challenging over the course of the next two years. While forecasting productivity trends is always difficult, chances are productivity gains will likely be hard to materialize, particularly in industries where regulatory constraints put in place in response to the crisis have the largest bite (the banking sector, for example). Wages will likely fare a bit better: a moderate pick-up will likely materialize sometime in mid-2016, when the remaining labor market slack has fully disappeared.

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Financial Markets: Unsettling Times Ahead

It has certainly been a tough summer on Wall Street. The market survived (but barely) a stomach-churning August when panic from the Chinese stock market swoon spread around the globe. To be sure, there were plenty of reasons to worry: after a meteoric rise, the Chinese stock market has collapsed by more than 40% — a larger drop than the post-dotcom bubble. The bungled attempt from Chinese officials to prop the market and a surprise depreciation of the yuan did not help matters: doubts began to creep about the ability of Chinese authorities to smoothly transition the command economy to a market-based one. Though the Chinese stock market is currently still roughly above 30% its year-ago levels, the panic that gripped the market this summer was enough to wreak havoc on market valuations with nearly $5 trillion being wiped out from global stock markets since August.

The US stock market swooned as fears of a Chinese contagion spread. By the end of August the S&P500 was down nearly 10% — entering what is considered by most a correction territory. Ironically, not too long ago the Fed Chairwoman — Janet Yellen — was chiding the market for too much complacency and not enough volatility. She got her wish: the VIX index shot up in August to levels last seen four years ago when the flare-up from the Eurozone threatened the global financial system. And though the markets have recovered since then, the S&P500 is still around 2% below its start-of-the-year levels. More concerning, there is ample evidence that the maturing six-year bull market will battle a number of headwinds over the next few quarters, which will likely restrain its performance and increase volatility.

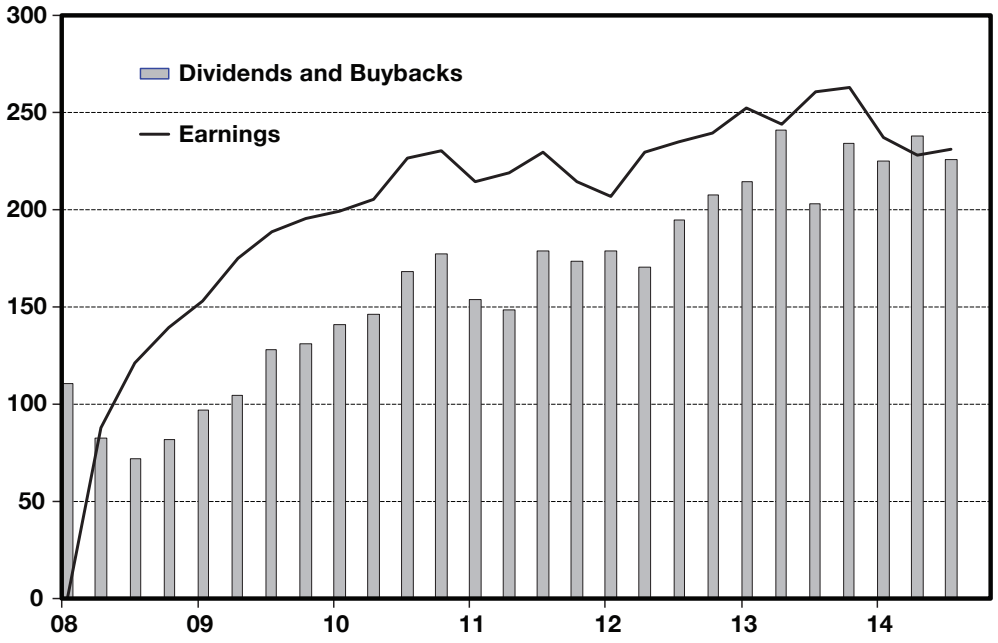
First, there are plenty of risks: concerns about the global slowdown and the imminent rate hiking of the Fed are expected to weigh on stocks over the next few quarters. It isn't just the start of the rate tightening: there is an unusual uncertainty surrounding this particular cycle — the first in nearly 9 years — which is further unsettling the markets. There is also no shortness of hand-wringing when it comes to the global economy: emerging markets (and, in particular, China) have slowed down perceptibly and there is plenty of worry to go around that the Chinese economy may be in even worse shape than what the official statistics indicate.

Since 2009, corporations have spent nearly $2 trillion dollars in share buybacks; ... So far in 2015, there have been nearly $3.5 trillion worth of M&A transactions.

Moreover, as we have argued for a while, equity valuations in the US do appear a bit bubbly: the cyclically adjusted PE ratio (based on inflation-adjusted earnings over the past 10 years) are within striking distance of their pre-crisis levels, marking this period the third highest in history. And though the summer swoon has partially corrected some of the excessive valuations seen earlier in the year, the market still appears around one-third more expensive than its historical average. Margin debt is also high — at a current $473 billion — despite the fact that it has edged down a bit from historically high levels of early summer.

Extended valuations seem to be borne partly by ultra-low interest rates, which have spurred a frenzy in share buy-backs and in Mergers and Acquisition activity. In face of softer earnings, companies have boosted stock prices either by buying back shares or by stepping up their M&A activity. In the second quarter of 2015, share buybacks and dividends (what companies returned to stockholders) were almost as high as earnings (both were roughly $230 billion) (Figure 10). Since 2009, corporations have spent nearly $2 trillion dollars in share buybacks; in 2014, nearly 95% of firms' profits were spent in share buybacks and dividends. Mergers and Acquisitions are also on track for a record year. So far in 2015, there have been nearly $3.5 trillion worth of M&A transactions.

FIGURE 10
Padding the Numbers: Dividends and Share Buybacks at Record Highs (level, billions of dollars)



This is not all that surprising: sales outlook during the recovery was quite uncertain and rock-bottom interest rates made it possible for firms to borrow cheaply and reinvest in their own shares. In addition, a boost in profits was largely gained by aggressive cost-cutting: now that the low-hanging fruits have nearly run out, companies are casting about to further cut costs through M&A activities. Share buybacks and M&As are partially responsible for a persistent under-investment in the capital stock: the ratio of business investments to corporate profits is currently half of its historical value. The buyback binge and increased M&A activity has increased earnings per share by 40% compared to pre-crisis levels, while sales per share have only risen by an uninspiring 2% over this period.

Risks

EI Decision: The Fed and Interest Rates — Hike Already!

After spending a good six months of the year raising expectations of a rate hike, the Fed decided not to decide (yet again) it its September meeting. It seems to us that the FOMC has been casting about for the last two years for an excuse to stay put on rates: first, it was slack in the labor market; then low inflation; lately, it has been a mixture of those two with a dose of global doom and gloom. One wonders whether the Fed has completely forgotten how to proceed: after all, the last tightening cycle began more than a decade ago (in 2004) and interest rates have remained unchanged for seven long biblical years (since December 2008).

The dithering has inflicted real costs in the world economy. Since "taper talk" began more than two years ago (in anticipation of the end of the Fed's quantitative easing program), more than $1 trillion has fled the emerging markets in search for higher yields elsewhere. Moreover, the imminent threat of a rate hike has strengthened the dollar by roughly 15% over the past year, significantly increasing the risk for corporate borrowers in the developing world, which have issued around $1.3 trillion in dollar-denominated bonds since 2010. It is small wonder that some emerging markets are now urging the Fed to move: since Fed chatter has already created an impression of a rate hike "sometime before the end of the year," it would be better to go ahead with it to get the whole thing over with rather than dither and create more instability in the financial world.

The biggest risk of further delays in the commencement of a rate-hiking cycle is the excessive risk taking and asset price misalignments that are becoming more visible and less elusive by the day: there are already signs that the stock market may be overvalued.

Low inflation and some remaining labor market slack coupled with global slow growth and financial turmoil are staying the Fed's hand. However, we have argued for a while that the arguments in favor of raising rates are quite strong. First, the labor market has improved appreciably, and it is tighter than it may appear upon first look. As we reasoned earlier, we believe that those who have left the labor market — the long-term unemployed, the discouraged, and the marginally attached — are unlikely to rejoin the labor market in droves. Wage inflation may not be imminent, but this is more of a reflection of low productivity than unresolved labor market slack. Second, the output gap may be smaller than what the Fed estimates: low productivity and slow growth in the labor force may have dented the economy's potential, at least in the near term. Third, low inflation rates are a reflection of a plunge in oil prices, imported deflationary pressures from abroad, and a sharp broad-based rise in the dollar. Though we forecast inflation to remain muted over the forecast horizon, we expect it to be around the Fed's target rate two years down the line. Given the lags with which monetary policy tends to affect the real economy, the Fed needs to tighten now in order to head-off the build-up in potential inflationary pressures.

But the biggest risk of further delays in the commencement of a rate-hiking cycle is the excessive risk taking and asset price misalignments that are becoming more visible and less elusive by the day: there are already signs that the stock market may be overvalued, M&A activity funded through riskier high-yield debt has reached new peaks, the amount of student loans has sky-rocketed, and auto loans have waddled well into the subprime segment of the market. Moreover, zero interest rates have fuelled stock buybacks with a seemingly safe tax advantage return rather than a splurge in investment spending by firms.

While most expected the Fed to move in September, we have long maintained that the first lift-off would come in December 2015 at the earliest. We are still of that view, even though currently the market is placing only a one-third chance that the Fed will move by December.

Our view for quite some time has been that the Fed has stayed excessively accommodative for far too long. Having said that, we have also maintained for a while that the first Fed hike will happen later than what the market consensus anticipated. While most expected the Fed to move in September, we have long maintained that the first lift-off would come in December 2015 at the earliest. We are still of that view, even though currently the market is placing only a one-third chance that the Fed will move by December. We also see a path to normalization that will be persistent and very gradual, with interest rates topping off at around 3%-3.25% range.

Chilly Winds: Reduced Expectations for the Global Economy

There are no shortages of gloomy news this year on the global economy. The US suffered an icy first quarter, and it appears that the third and fourth quarters will be less inspiring than previously hoped. China has slowed down perceptively, and the erratic and fumbling response by the Chinese authorities has spiked fears that things may be worse and a hard landing may be unavoidable. Dollar strength, a downshift in Chinese growth, an imminent tightening from the Fed, and a slew of structural issues have further weakened the outlook for emerging markets. The plunge in commodity prices has taken the wind out of resource-driven economies, such as Australia and Canada. The Greek crisis flared up again mid-summer as the country narrowly avoided default after first rejecting and then accepting a deal with the creditors. In Euroland, the bout of optimism that was felt earlier in the year came to a halt in midyear when it became evident that the single-currency area would muster only middling growth, much as it has been the case over the past two years. In Japan, real GDP growth has been negative in four out of the past seven quarters, as spending has failed to revive meaningfully since the consumption tax hike of April 2014, and exports slumped due to the slowing global economy.

Our view is that the Chinese economy will manage to avoid a hard landing, but it will experience a bumpier ride than most anticipate.

The fate of the Chinese economy is perhaps the most troublesome out of all these developments. Simply put, in terms of sheer size and rapid growth rate, China matters more nowadays to the global economy than any other country. Since the Great Recession, China has accounted for a third of the expansion in the global economy. In contrast, the contribution from the US to global growth has been around 20%, while Europe and Japan combine for roughly 10%. But China has had a rather tumultuous year: construction has downshifted significantly from its previous unsustainable pace, investment spending is growing at the slowest pace in over a decade, and the stock market suffered an epic collapse. Manufacturing and factory orders have also slowed down significantly. Adding further to the concerns is the nagging suspicion that the Chinese authorities may not be able to exert as much control over events as they once did. The surprise devaluation of yuan this summer — though modest and likely warranted due its recent appreciation — fueled market panic rather than assuage the fears about the state of the Chinese economy.

Our view is that the Chinese economy will manage to avoid a hard landing, but it will experience a bumpier ride than most anticipate. The current 7% growth reported by official statistics does not quite match up to reality, which appears to be more modest (likely in the 5.5%-6.5% rate). Our more cautious outlook stems from the view that most key Chinese statistics seem to be stalled: production activity will likely continue to be a drag, the property market appears oversupplied, and credit markets seem bubbly. The balancing act from investments and exports to a consumer-driven economy will take longer and weigh more on Chinese growth than many expect.

Overall, we expect the global economy to expand by 2.9% in 2015 and 3.1% in 2016 — below its historical average of 3.5%.

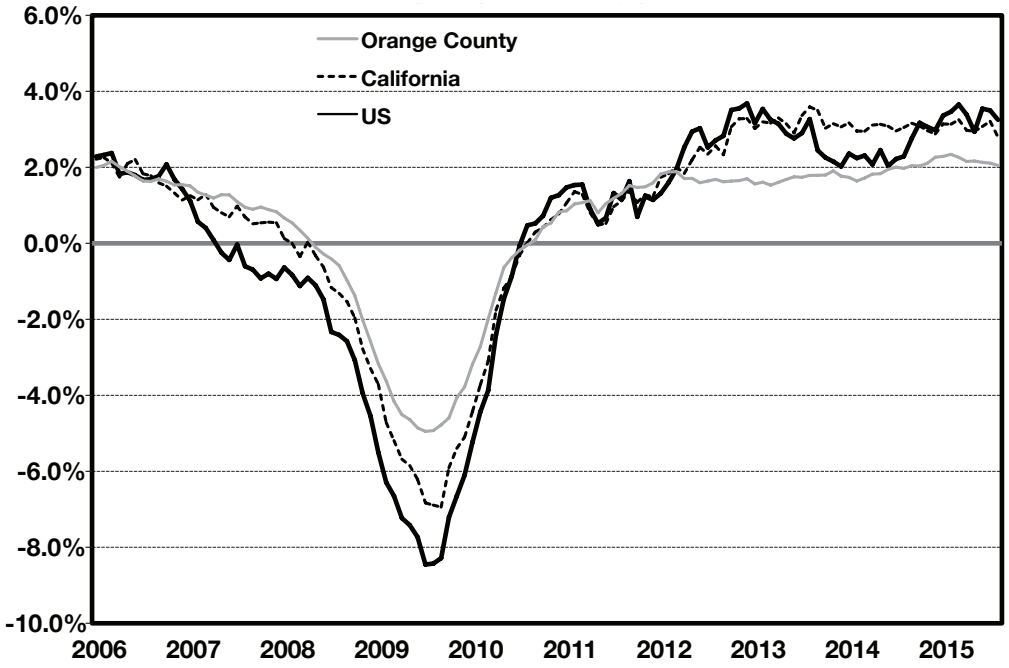
Elsewhere, growth will continue to muddle along. The ECB's quantitative easing program will likely be extended beyond its initial horizon (September 2016); coupled with a weaker euro and a slump in oil prices, it should help Eurozone grow by 1.5%-1.8% over the forecast horizon. The recent migrant crisis in Europe will not help the geo-political order in the region and will likely weigh on resources, at least in the short term. Continued easy monetary policy from the Bank of Japan should be growth supportive though we expect Japan to eke out meager growth over the forecast horizon, weighted down by structural forces (aging demographics, high debt, and low fertility). Overall, we expect the global economy to expand by 2.9% in 2015 and 3.1% in 2016 — below its historical average of 3.5%.

ORANGE COUNTY AND SOUTHERN CALIFORNIA

California's recovery has picked up momentum in the last eighteen months and, in fact, job growth in the state is faster than for the nation as a whole (Figure 11). To be sure, the phenomenon owes its above-average performance to the heated job market in the Silicon Valley, but employment growth in Southern California and Orange County has shown marked improvement over the past year. An even better news comes on the sentiment front: local consumer and business sentiment surveys indicate continued optimism and improved household financial health. All this portends further growth in the coming years and an expansion that continues with a more rapid clip and a more confident pace. While the continued drought will negatively impact the economy, especially California's agriculture sector, better performance in high-tech, housing, and exports is expected to keep the overall growth on a steady path during our forecast horizon.

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FIGURE 11
Payroll Employment Growth: Orange County vs. California (y-o-y percent change)

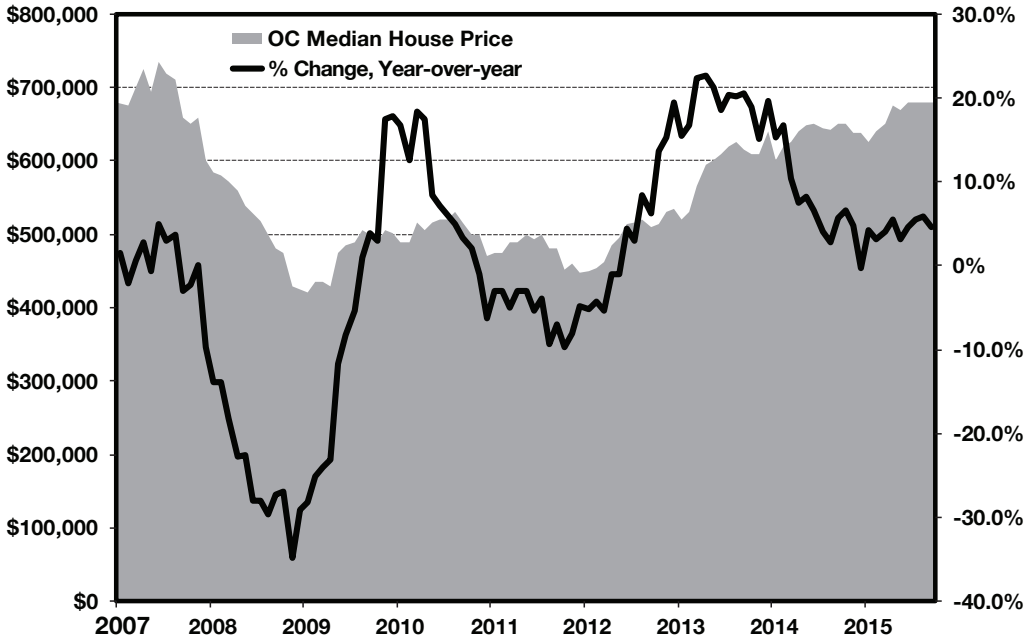


Housing and Construction

A large portion of the epic collapse in home values during the Great Recession has been regained by the solid price increases posted during the last few years.

As we anticipated in our last report, the housing market continues to mend in Southern California and construction has started to pick up. A large portion of the epic collapse in home values during the Great Recession has been regained by the solid price increases posted during the last few years. For example, the median price of a single-family home in Orange County has increased from $420,000 in January 2009 to $680,000 in September 2015 (Figure 12). This is an increase of 62% and puts the median price at the same level as it was almost ten years ago, in September 2006. It is, however, still below the level reached in June 2007 when the median price for the county peaked at $735,000.

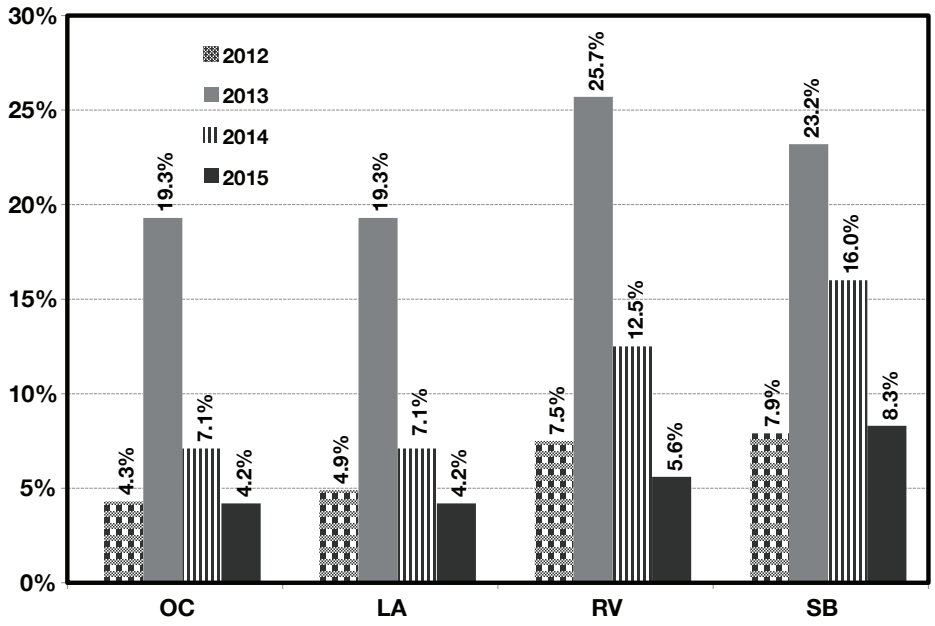
FIGURE 12
Orange County Median Home Prices
(level and percent change)



In Los Angeles, the median price of a single-family home has risen from $295,000 in April 2009 to $509,000 in September 2015. This amounts to a staggering 72% increase, but the current price is still below the peak of $605,000 reached in August 2007. Likewise, in Riverside County, the current median price of $310,000 is 84% higher than the low of $170,000 reached in May 2009, though this is still -26% below the previous record of $419,000 observed in June 2006. San Bernardino is unquestionably the county that experienced the wildest swing in Southern California: the current median price of $255,000 is 92% higher than the $133,000 level reached in May 2009. But it is still a ways off from the high of $370,000 recorded in January 2007.

As we had cautioned in our last report, home price appreciation rates are cooling significantly across all regions of Southern California. All counties posted above 20% growth rates in 2013 — in 2014, the pace downshifted to less than half that value in Orange County and Los Angeles (7%), with Riverside home prices rising by 12% and San Bernardino by 16%. The current year has been even more downbeat: from January to August 2015, the average price appreciation has moderated further to 4% for Orange County, 4.2% for Los Angeles, 5.6% for Riverside, and 8.3% for San Bernardino (Figure 13).

FIGURE 13
Home Prices: A Cross-County Perspective
(year-over-year, percent change)



This cooling off was expected given the blistering pace of increase in the previous three years. The surplus housing from foreclosures has been pretty much wiped out and largely absorbed. The slow recovery in jobs, and even slower improvement in wages, is constraining housing purchases, especially at the lower end. The low mortgage rates obviously are not enough of an incentive, and a large number of households fail to qualify for a mortgage given the rather stringent credit requirements enacted after the recession.

Construction activity is slowly edging up. In fact, an imminent sign that things are looking up is the current pick up in Construction payroll employment: construction payrolls in the county have risen from a sizably shrunk 68,000 in 2010 to over 91,000 employees in August 2015. Other neighboring counties have seen similar patterns: employment in the construction sector in Los Angeles County grew from a cycle low of 104,500 to a current 129,100 while the Inland Empire (Riverside and San Bernardino) showed a growth from 59,700 to 84,300. The broader Southern California region posted an increase in construction jobs of nearly 75,000, with this sector expanding from 243,550 recorded at the height of the crisis to a current 319,000. Despite these improvements, employment in this sector for all counties is still significantly below levels reached before the Great Recession.

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Construction permits in Orange County rose to 9,900 for 2013 and 2014 and are expected to increase by roughly 4% during 2015. Construction picked up more buoyantly in Los Angeles County, rising by a solid 16.3% in 2013 and an additional 19% in 2014. We project this pace of growth to continue and expect permits to rise by over 20% in both 2015 and 2016. As expected, activity continues to remain more subdued in the Inland Empire, though we anticipate it will accelerate over the next two years as the recovery in the two-county area continues to expand. For the Southern California region as a whole, we expect a continuing improvement of 8%–9% in construction permits over the next two years. Construction spending in both residential and commercial areas will keep pace as economic conditions improve.

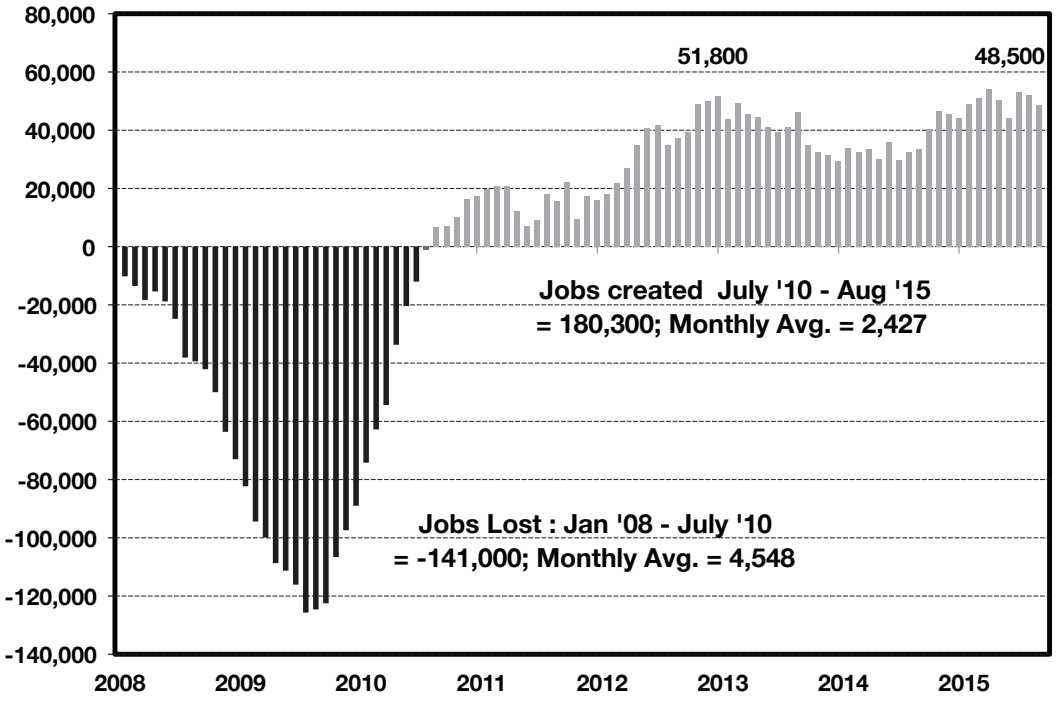
The Labor Market: Overview and Forecasts

Labor markets in Orange County and the broader Southern California region have remained decidedly upbeat during the past year, extending their previous gains

Labor markets in Orange County and the broader Southern California region have remained decidedly upbeat during the past year, extending their previous gains. Unemployment rates in all counties have fallen precipitously since the end of the recession. The current 4.5% unemployment rate for Orange County is less than half the 9.7% average recorded in 2010 — at the height of the crisis. The unemployment rate in Los Angeles County fell from an average high of 12.5% in 2010 to 7% in August 2015; likewise unemployment in the Inland Empire declined from an average rate of 13.7% in 2010 to approximately 7% currently. These pattern mimic the rate of labor market healing that has occurred throughout the State of California: the jobless rate at the state level has fallen from a high of 12.2% to a current rate of 6.1%

Total payroll employment has also expanded noticeably. In a much-anticipated development, total payroll employment for Orange County this year is expected to exceed the previous employment peak reached in 2006. This seems rather mediocre, considering that it took the county nearly a decade to climb up to its earlier high even as the population has expanded by roughly 8% over this period. This is partially due to the depth of the crisis and its devastating impact on the county's employment and partially due to the slow recovery. A total of 141,000 jobs were lost in the county from January 2008 to July 2010 for an average monthly rate of 7,050. Since then, from August 2010 to August 2015, the county added 180,300 jobs for a monthly gain of 3,005 (Figure 14). In other words, the monthly job decline during the recession was 135% faster than the subsequent job gains. The picture is equally disheartening for the broader six-county Southern California region (which includes Orange, Los Angeles, Riverside, San Bernardino, Ventura, and Imperial). The region lost a total of 812,300 jobs from January 2008 to July 2010, for a monthly average of 30,615. Since then,

FIGURE 14
Orange County Payroll Employment
(year-over-year changes)



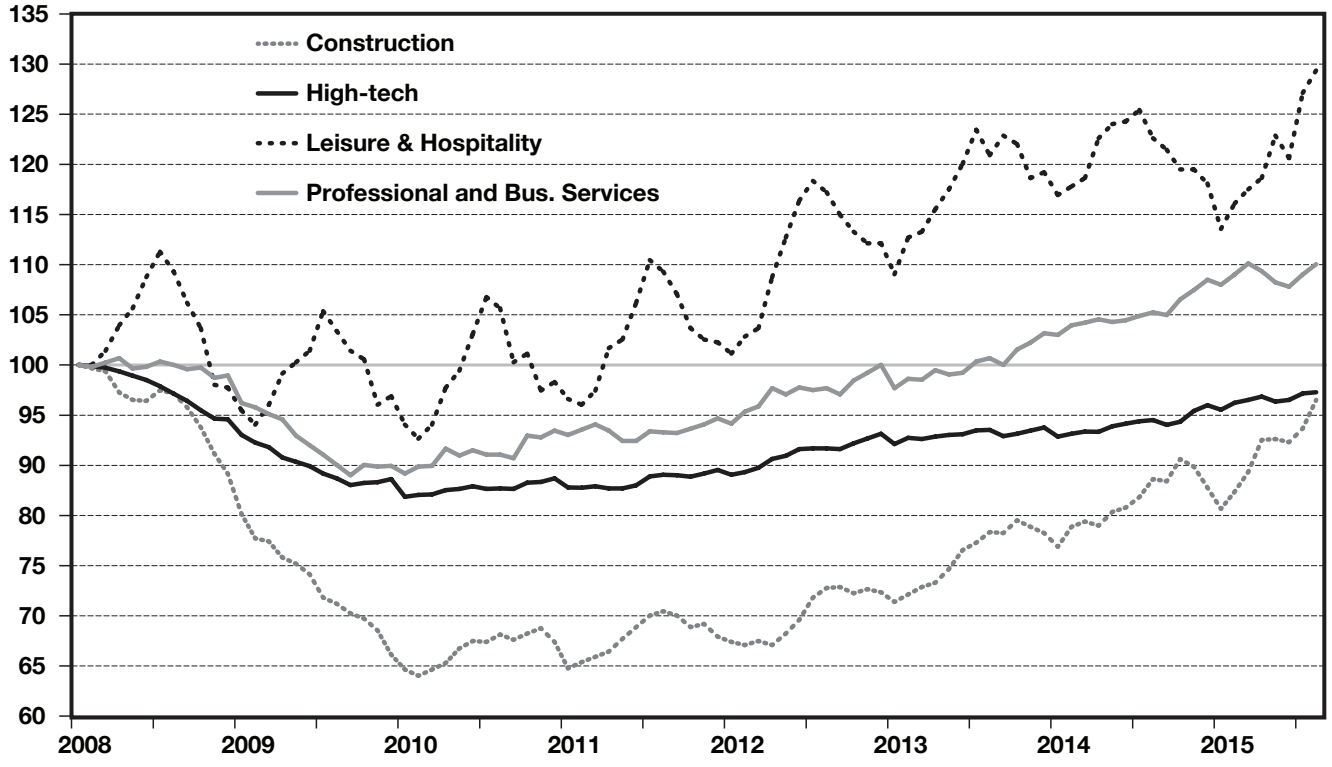
total job gain has exceeded the losses suffered during the recession (payroll employment swelled by 846,500 jobs from August 2010 through August 2015), but the monthly gain — at 14,108 — is less than half of the monthly losses registered during the recession (Table 1). This means that the monthly rate of decline was 117% faster than the recovery rate. For the State of California, the comparable monthly rate of decline was 65% faster than the recovery rate. The state has performed better than the Southern California region because of the more moderate impact of recession and a faster recovery in employment rolls in Northern California, which have tended to blunt the weaker performance of the Southern region.

TABLE 1
Employment Gains and Losses During and After Recession

	OC		SC		CA	
Jan 2008-July 2010	(141,000)	(7,050)	(812,300)	(30,615)	(1,074,400)	(53,720)
Aug 2010 - Aug 2015	180,300	3,005	846,500	14,108	1,951,400	32,523
Ratio of Monthly Losses to Gains		2.35		2.17		1.65

For Orange County, the diversity of its economy has been a traditional source of stability during cyclical turmoil. The construction sector has been a source of strength over the past year: employment rolls fell by more than 30% during the housing collapse but have recovered nicely and are currently only 4% below their 2007 levels (Figure 15). Professional and Business Services employment, which fell by nearly 15% during the recession, has also improved, albeit distinctively more slowly, and is currently roughly around 3% below its pre-recession level. Employment in the High-Tech sector is now approximately 10% higher than its pre-recession level, but the growth during the last year has been uneven. The other two sectors that have performed quite stellar over this period are Leisure and Hospitality (29% above previous peak) and Health Care and Social Assistance (33% above previous peak).

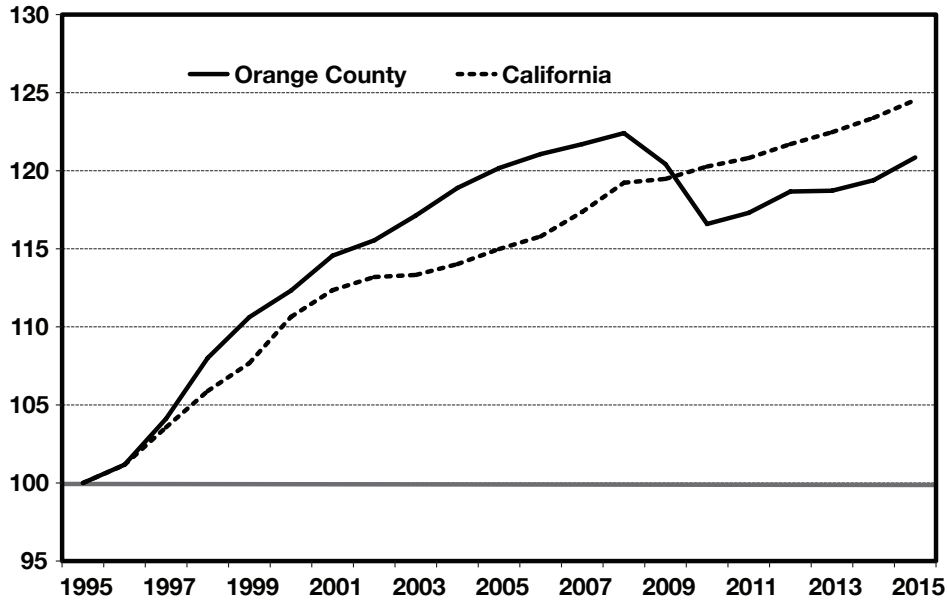
FIGURE 15
OC Major Sector Employment
(Index level, Jan 2008 = 100)



While the diverse sectors of Orange County cushion the cyclical volatility, the overall pace of the labor market recovery in the county continues to be below expectations.

But while the diverse sectors of Orange County cushion the cyclical volatility, the overall pace of the labor market recovery in the county continues to be below expectations. The slow job growth has a multi-dimensional explanation, as pointed out in the national economy portion of this report. Though it is difficult at this time to draw final conclusions about factors underlying this phenomenon, it is clear that sea changes in individual attitude with respect to leisure/work trade-off are a significant factor. Labor force participation rates (the percentage of the civilian non-institutionalized adult population that is either employed or unemployed) have been declining across the country and the recession accelerated these trends (Figure 16).

FIGURE 16
Labor Force Growth: Orange County vs. California
(index level, 1995=100)



The labor force participation rate is one of the main indicators of the health of the labor market, and a decline in the rate can signal trouble in the labor market. A decline could be caused by the unemployed giving up looking for work because of poor prospects ("discouraged workers") or an increase in people receiving Social Security Disability Insurance (SSDI) benefits. Not all declines signal problems, however. For example, it widely expected that the labor force should expand at a more modest pace over the next few decades due to the aging of the population and the retirement of the baby boomer generation.

Similar to the national trend, the labor force participation rate has fallen in Orange County since the beginning of 2007.

Similar to the national trend, the labor force participation rate has fallen in Orange County since the beginning of 2007. However, the rate is slower than what is recorded nationally. The labor force participation rate in Orange County fell from 66.8% in 2007 to 65.8% in 2014, compared to a decline from 64.8% in 2007 to 63.3% in 2014 for the United States as a whole, according to data from the American Community Survey.

To control for the effects of baby boomers' retirements on labor force participation, we examine labor force participation by age cohort, as displayed in Table 2. Economists are particularly concerned about the labor force participation rates of prime-age workers (aged 25-54), who are the most active in the labor market, because a decline in participation in this group is unlikely to be caused by additional retirements and more likely to be caused by an increase in discouraged workers, people receiving disability benefits, or people needing to go back to school full time to retrain for a new

career. The good news here is that the troubling decline in participation of prime-age workers that has plagued the US is not shared by Orange County. In fact, the labor force participation rate for prime-age workers in Orange County has increased by about 1 percentage point from 2007-2014.

Orange County's decreasing overall labor force participation rate is explained primarily by the aging population and a sharp decline in labor force participation rate of young people, aged 16-19. While participation among 16-19 year olds decreased by over 6 percentage points for the country as a whole between 2007 and 2014, it declined by more than 11 percentage points in Orange County.

Table 2 also includes Orange County's percentile rank for each participation rate, which indicates the percentage of US counties that have a participation rate less than Orange County in that year. Participation rates among the young aged was at the 18th percentile among US counties in 2007 and fell to the 10th percentile by 2014, indicating that Orange County's young people's participation has decreased much more quickly compared to other counties in the United States.

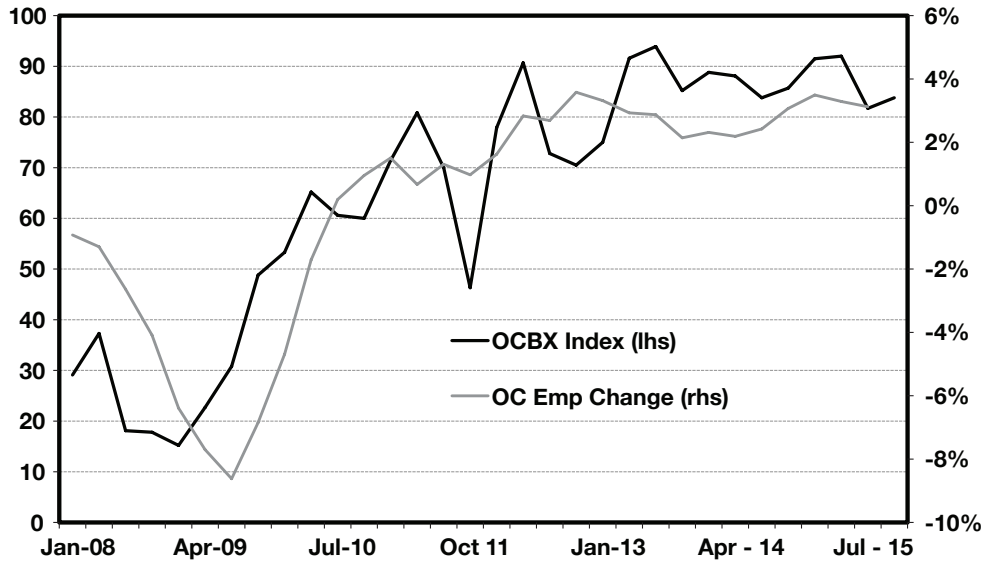
The Orange County Business Expectations survey (OCBX), conducted by the Cal State Fullerton's Woods Center for Economic Analysis and Forecasting, rose in its latest reading (September) after slumping in July (Figure 17). The overall value of the index, a weighted average of several survey questions, moved up to 85.7 in the fourth quarter of 2014 from 83.8 the previous quarter. A reading above 50 indicates continued growth. The index has fluctuated within a narrow range of three points of its current value for the last three quarters and has proven accurate in the past in predicting future job changes in Orange County.

The troubling decline in participation of prime-age workers that has plagued the US is not shared by Orange County. In fact, the labor force participation rate for prime-age workers in Orange County has increased by about 1 percentage point from 2007-2014.

TABLE 2
Labor Force Participation Rates

	UNITED STATES		ORANGE COUNTY			
	Labor Force Participation Rate (%)		Labor Force Participation Rate (%)		Percentile Rank among US Counties	
AGE GROUP	2007	2014	2007	2014	2007	2014
Overall	64.8	63.3	66.8	65.8	61.7	66.6
16-19 Years Old	44.2	37.6	38.9	27.8	17.8	10
20-24 Years Old	74.9	74.1	75.8	74.1	44.6	37.9
25-44 Years Old	81.9	82	81.6	82.2	34.7	47
45-54 Years Old	80.4	79.9	81.9	83.6	55.3	73.1
55-64 Years Old	62.5	64.2	66.7	69.2	75.9	76.3
65-74 Years Old	23.9	25.3	27.1	29.7	76.2	79.3
75+ Years Old	5.6	6.3	6.8	6.3	75.1	52.3

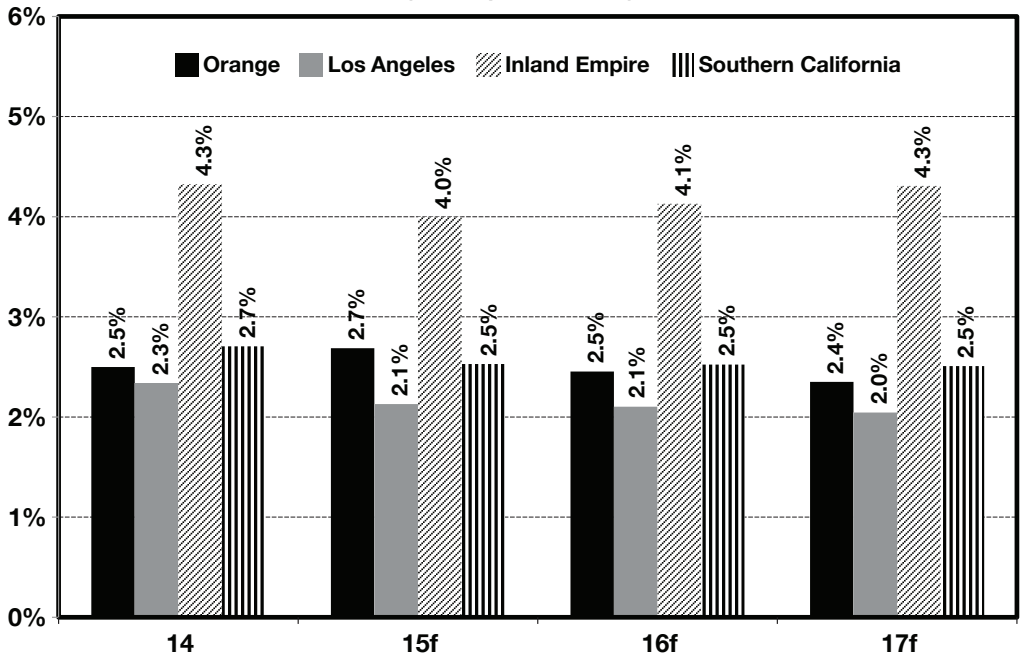
FIGURE 17
Orange County OCBX Index and Employment Change
(index level and employment y-o-y percent change)



Our outlook is for an increasingly improved economic performance at the county and regional level over the forecast horizon.

Our outlook is for an increasingly improved economic performance at the county and regional level over the forecast horizon. We expect Orange County's unemployment rate to decline from an average rate of 5.5% in 2014 to 4.4% in 2015 and 4.3% in 2016. The county's economy is expected to add 40,100 payroll jobs in 2015 (2.7% increase) and 37,700 jobs in 2016 (2.5%) (Figure18). The comparable figures for the six-county Southern California region are for total employment gains of 186,000 in 2015 (2.5%) and 191,700 in 2016 (2.5%). Details data for all the counties are given in the following tables.

FIGURE 18
Payroll Employment Forecasts
(annual percent rates)



Robert Giuliano provided expert research assistance in preparation of the Southern California and Orange County forecasts, but any errors are the authors' responsibility.

TABLE 1 - NATIONAL

	2010	2011	2012	2013	2014	2015f	2016f	2017f	3-year change 2016-2013 (average change)
GDP									
Real GDP (Bil. $)	14,784	15,021	15,355	15,583	15,962	16,345	16,770	17,189	1,227
% change RGDP	2.5	1.6	2.2	1.5	2.4	2.4	2.6	2.5	2.5
Nominal GDP (Bil. $)	14,964	15,518	16,155	16,663	17,348	17,973	18,745	19,570	2,222
% change Nominal GDP	3.8	3.7	4.1	3.1	4.1	3.6	4.3	4.4	4.1
RGDP Components									
Personal Consumption (% change)	1.9	2.3	1.5	1.7	2.7	2.9	3.0	2.6	2.8
Business Fixed Investment (% change)	1.5	6.3	9.8	4.2	5.3	4.7	6.0	5.8	5.5
Residential (% change)	1.9	3.6	3.9	3.8	5.2	9.2	10.8	8.5	9.5
Nonresidential (% change)	2.5	7.7	9	3	6.2	3.6	4.8	5.0	4.5
Exports (% change)	11.9	6.9	3.4	2.8	3.4	1.5	3.8	4.3	3.2
Imports (% change)	12.7	5.5	2.2	1.1	3.8	5.7	5.8	5.5	5.7
Current Account Balance (Bil. $)	-446	-482	-468	-396	-401	-450	-490	-530	-129
Current Account Balance (% of GDP)	-3.0	-3.1	-2.9	-2.4	-2.3	-2.5	-2.6	-2.7	9.7
Federal Deficit (Bil. $)	-1,294	-1,297	-1,089	-680	-483	-457	-517	-567	-84
Labor Sector									
Unemployment Rate (%)	9.6	8.9	8.1	7.4	6.2	5.3	4.9	4.8	5.0
Payroll Employment (% change)	-0.7	1.2	1.7	1.7	1.9	1.9	1.7	1.4	1.7
Average Weekly Hours (saar)	34.1	34.3	34.4	34.4	34.5	34.5	34.6	34.6	0.1
Labor Productivity (%, saar)	3.3	0.1	0.7	0.4	0.6	0.5	1.4	1.7	1.2
Prices and Wages									
CPI (% change)	1.6	3.1	2.1	1.5	1.6	0.3	1.6	2.0	1.3
Core CPI (% change)	1.0	1.7	2.1	1.8	1.7	1.7	1.8	2.0	1.8
GDP Deflator (% change)	1.2	2.1	1.8	1.6	1.6	1.1	1.7	1.8	1.5
Employment Cost Index (% change)	1.9	2.2	1.9	1.9	2.1	2.2	2.6	2.9	2.6
Unit Labor Costs (% change)	-1.3	2.1	1.7	1.1	2.0	2.0	2.4	2.5	2.3
Income									
Personal Income (% change)	3.2	6.2	5.0	1.1	4.4	4.3	4.8	4.7	4.6
Real Disposable Income (% change)	1.0	2.5	3.1	-1.4	2.7	3.2	3.0	2.9	3.0
Savings Rate (% of disp. income)	5.6	6.1	7.6	4.8	4.8	5.0	4.8	5.3	5.0
After-Tax Profits (% change)	22.0	4.5	7.9	1.2	-0.6	1.7	4.7	4.3	3.6
Financial Markets									
Federal Funds Rate (%)	0.18	0.10	0.14	0.11	0.09	0.20	0.92	1.85	1.76
3-Month T-bill Rate (%)	0.14	0.05	0.09	0.06	0.03	0.05	0.83	1.67	1.64
10-Year Treasury Note (%)	3.21	2.79	1.80	2.35	2.54	2.18	2.62	2.87	0.33
30-Year Fixed Mortgage Rate (%)	4.69	4.46	3.66	3.98	4.17	3.85	4.25	4.62	0.45
Exchange Rate, Major Trading Partners (% change)	-3.0	-5.9	3.7	3.3	3.3	15.6	1.7	2.3	6.3
Other Key Measures									
Oil - WTI ($ per barrel)	79.8	110.9	111.8	108.7	99.8	54.4	56.8	65.3	-34.5
Industrial Production (% change)	5.6	3.0	2.8	1.9	3.7	1.3	2.3	2.8	2.1
Housing Starts (Mill. units, saar)	0.586	0.612	0.784	0.928	1.001	1.156	1.287	1.402	0.401
Existing Home Sales (Mill. units, saar)	4.183	4.277	4.657	5.074	4.920	5.214	5.423	5.498	0.578
Consumer Confidence Index (Conference Board, level)	54.5	58.1	67.1	73.2	86.9	97	98.1	95.4	8.5

TABLE 2 - ORANGE COUNTY

Levels in thousands

Population

	2013	2014f	2015f	2016f	2017f
Total Population	3,114.4	3,141.6	3,168.9	3,196.5	3,224.1
Annual Percentage Change	0.9%	0.9%	0.9%	0.9%	0.9%

Household Employment

	2013	2014	2015f	2016f	2017f
Labor Force	1,566.8	1,575.6	1,598.0	1,614.0	1,627.9
Total Employment	1,464.9	1,489.2	1,530.7	1,553.1	1,570.7
Total Unemployment	101.9	86.4	70.1	68.7	69.7
Unemployment Rate	6.5%	5.5%	4.4%	4.3%	4.3%

Wage & Salary Employment

	2013	2014	2015f	2016f	2017f
Total Nonfarm	1,459.4	1,495.9	1,536.1	1,573.8	1,610.8
Goods Producing	235.5	241.5	250.2	259.6	269.7
Mining and Logging	0.6	0.7	0.7	0.7	0.7
Construction	76.8	82.0	87.4	93.5	100.4
Manufacturing	158.0	158.8	162.1	165.4	168.6
Durable Goods	115.1	116.6	118.6	120.7	122.8
Nondurable Goods	43.0	42.2	43.5	44.7	45.8
Service Providing	1,224.0	1,254.4	1,285.9	1,314.2	1,341.1
Trade, Transportation and Utilities	252.4	257.0	261.3	267.2	273.0
Wholesale Trade	79.4	81.7	83.1	84.8	86.6
Retail Trade	145.5	148.7	150.6	153.7	156.9
Transportation, Warehousing and Utilities	27.5	26.6	27.6	28.7	29.5
Information	25.0	24.2	24.2	24.8	25.3
Financial Activities	113.1	114.1	116.2	116.9	117.2
Professional and Business Services	267.3	275.8	283.3	293.1	303.9
Educational and Health Services	184.2	190.3	198.8	203.5	206.7
Leisure and Hospitality	187.8	193.5	197.9	202.5	207.0
Other Services	45.6	47.7	50.7	52.0	52.7
Government	148.7	151.9	153.6	154.3	155.3

Percentage change

	2013	2014	2015f	2016f	2017f
Total Nonfarm	2.8%	2.5%	2.7%	2.5%	2.4%
Goods Producing	2.3%	2.6%	3.6%	3.8%	3.9%
Mining and Logging	5.5%	9.1%	-0.4%	-1.1%	-0.8%
Construction	7.7%	6.8%	6.5%	7.0%	7.4%
Manufacturing	-0.2%	0.5%	2.1%	2.0%	1.9%
Durable Goods	0.5%	1.4%	1.7%	1.8%	1.7%
Nondurable Goods	-2.1%	-1.9%	3.2%	2.8%	2.4%
Service Providing	2.9%	2.5%	2.5%	2.2%	2.0%
Trade, Transportation and Utilities	1.3%	1.8%	1.7%	2.3%	2.2%
Wholesale Trade	2.8%	2.9%	1.7%	2.0%	2.2%
Retail Trade	1.1%	2.1%	1.3%	2.1%	2.1%
Transportation, Warehousing and Utilities	-2.0%	-3.0%	3.6%	4.1%	2.5%
Information	2.8%	-3.2%	0.1%	2.5%	2.1%
Financial Activities	4.4%	0.9%	1.8%	0.6%	0.3%
Professional and Business Services	2.6%	3.2%	2.7%	3.5%	3.7%
Educational and Health Services	6.0%	3.3%	4.4%	2.4%	1.6%
Leisure and Hospitality	4.0%	3.0%	2.3%	2.3%	2.2%
Other Services	2.1%	4.6%	6.4%	2.5%	1.4%
Government	0.6%	2.2%	1.1%	0.5%	0.6%

Levels in millions

Personal Income

	2013	2014f	2015f	2016f	2017f
Personal Income	169.8	177.6	185.4	194.0	204.1
Annual Percentage Change	1.9%	4.6%	4.4%	4.6%	5.2%
Per Capita Income ($)	$54,519	$56,539	$58,512	$60,683	$63,318

Taxable Sales

	2013	2014f	2015f	2016f	2017f
Total Taxable Sales	57.6	60.4	63.6	67.6	71.5
Year to Year Percentage Change	4.3%	4.8%	5.4%	6.3%	5.7%

TABLE 3 - SOUTHERN CALIFORNIA

Levels in thousands

Population

	2013	2014F	2015f	2016f	2017f
Total Population	18,588.6	18,793.0	19,000.9	19,211.9	19,425.4
Annual Percentage Change	1.1%	1.1%	1.1%	1.1%	1.1%

Household Employment

	2013	2014	2015f	2016f	2017f
Labor Force	8,959.1	9,033.2	9,142.8	9,246.5	9,367.6
Total Employment	8,130.3	8,327.3	8,528.8	8,667.8	8,787.9
Total Unemployment	828.7	705.9	612.8	583.9	598.1
Unemployment Rate	9.2%	7.8%	6.7%	6.3%	6.4%

Wage & Salary Employment

	2013	2014	2015f	2016f	2017f
Total Nonfarm	7,160.4	7,354.2	7,540.2	7,730.5	7,924.4
Goods Producing	931.3	949.3	973.8	1,006.1	1,040.0
Mining and Logging	9.7	10.3	9.9	9.7	10.0
Construction	275.6	292.9	314.2	336.4	359.8
Manufacturing	645.9	646.1	649.6	660.0	670.2
Durable Goods	395.4	398.6	400.9	407.2	415.5
Nondurable Goods	250.6	247.6	248.8	252.7	254.6
Service Providing	6,229.1	6,404.8	6,566.4	6,724.4	6,884.4
Trade, Transportation and Utilities	1,404.6	1,444.3	1,476.7	1,507.4	1,540.9
Wholesale Trade	369.2	379.0	390.9	394.5	402.1
Retail Trade	763.2	780.3	792.5	813.3	828.7
Transportation, Warehousing and Utilities	272.2	285.0	293.3	299.6	310.0
Information	238.4	237.1	236.9	235.8	239.5
Financial Activities	387.3	386.6	392.3	393.9	393.9
Professional and Business Services	1,033.4	1,061.2	1,093.4	1,123.3	1,150.0
Educational and Health Services	1,135.7	1,182.0	1,216.3	1,256.6	1,294.6
Leisure and Hospitality	800.6	841.5	875.8	917.8	957.3
Other Services	242.8	253.3	260.2	263.6	267.3
Government	986.4	999.0	1,014.7	1,026.1	1,041.0

Percentage change

	2013	2014	2015f	2016f	2017f
Total Nonfarm	3.2%	2.7%	2.5%	2.5%	2.5%
Goods Producing	2.5%	1.9%	2.6%	3.3%	3.4%
Mining and Logging	9.5%	6.3%	-3.7%	-2.2%	2.8%
Construction	8.1%	6.3%	7.3%	7.1%	7.0%
Manufacturing	0.2%	0.0%	0.5%	1.6%	1.5%
Durable Goods	0.3%	0.8%	0.6%	1.6%	2.0%
Nondurable Goods	0.0%	-1.2%	0.5%	1.6%	0.8%
Service Providing	3.3%	2.8%	2.5%	2.4%	2.4%
Trade, Transportation and Utilities	2.4%	2.8%	2.2%	2.1%	2.2%
Wholesale Trade	3.8%	2.7%	3.1%	0.9%	1.9%
Retail Trade	1.4%	2.2%	1.6%	2.6%	1.9%
Transportation, Warehousing and Utilities	3.1%	4.7%	2.9%	2.1%	3.5%
Information	2.3%	-0.6%	-0.1%	-0.5%	1.6%
Financial Activities	1.6%	-0.2%	1.5%	0.4%	0.0%
Professional and Business Services	3.6%	2.7%	3.0%	2.7%	2.4%
Educational and Health Services	7.2%	4.1%	2.9%	3.3%	3.0%
Leisure and Hospitality	5.1%	5.1%	4.1%	4.8%	4.3%
Other Services	2.6%	4.3%	2.8%	1.3%	1.4%
Government	-0.4%	1.3%	1.6%	1.1%	1.4%

Levels in millions

Personal Income

	2013	2014f	2015f	2016f	2017f
Personal Income	828.7	863.5	898.5	937.0	983.0
Annual Percentage Change	2.3%	4.2%	4.0%	4.3%	4.9%
Per Capita Income ($)	$44,579	$45,949	$47,286	$48,772	$50,603

Taxable Sales

	2013	2014f	2015f	2016f	2017f
Total Taxable Sales	275.4	289.2	303.5	318.8	334.1
Year to Year Percentage Change	4.9%	5.0%	4.9%	5.0%	4.8%

TABLE 4 - LOS ANGELES COUNTY

Levels in thousands

Population

	2013	2014f	2015f	2016f	2017f
Total Population	10,017.1	10,080.7	10,146.4	10,214.2	10,283.6
Annual Percentage Change	0.7%	0.6%	0.7%	0.7%	0.7%

Household Employment

	2013	2014	2015f	2016f	2017f
Labor Force	4,982.3	5,025.9	5,085.3	5,131.5	5,201.1
Total Employment	4,495.7	4,610.8	4,715.6	4,784.4	4,839.5
Total Unemployment	486.6	415.1	369.7	347.1	361.6
Unemployment Rate	9.8%	8.3%	7.3%	6.8%	7.0%

Wage & Salary Employment

	2013	2014	2015f	2016f	2017f
Total Nonfarm	4,129.8	4,226.4	4,316.4	4,407.1	4,497.3
Goods Producing	488.9	489.7	495.1	501.7	507.2
Mining and Logging	4.6	4.7	4.5	4.4	4.4
Construction	116.2	120.2	128.1	134.2	139.2
Manufacturing	368.2	364.9	362.5	363.1	363.5
Durable Goods	204.3	203.1	202.0	201.8	202.9
Nondurable Goods	163.8	161.8	160.5	161.3	160.7
Service Providing	3,640.8	3,736.7	3,821.3	3,905.4	3,990.1
Trade, Transportation and Utilities	782.2	800.7	818.8	832.6	847.6
Wholesale Trade	218.7	223.5	231.3	232.7	235.6
Retail Trade	406.0	414.5	423.1	433.7	442.3
Transportation, Warehousing and Utilities	157.5	162.7	164.4	166.2	169.6
Information	196.4	195.9	195.7	195.2	197.3
Financial Activities	211.7	209.7	211.6	215.2	218.6
Professional and Business Services	594.7	609.4	619.2	632.5	642.5
Educational and Health Services	719.6	748.0	768.5	785.8	805.6
Leisure and Hospitality	439.3	464.6	485.5	512.2	537.6
Other Services	145.7	151.7	154.8	155.5	156.9
Government	551.2	556.7	567.3	576.3	583.9

Percentage change

	2013	2014	2015f	2016f	2017f
Total Nonfarm	3.0%	2.3%	2.1%	2.1%	2.0%
Goods Producing	1.7%	0.2%	1.1%	1.3%	1.1%
Mining and Logging	8.6%	1.1%	-4.5%	-0.9%	-0.2%
Construction	6.4%	3.5%	6.6%	4.7%	3.7%
Manufacturing	0.2%	-0.9%	-0.7%	0.2%	0.1%
Durable Goods	0.0%	-0.6%	-0.5%	-0.1%	0.5%
Nondurable Goods	0.5%	-1.2%	-0.8%	0.5%	-0.4%
Service Providing	3.1%	2.6%	2.3%	2.2%	2.2%
Trade, Transportation and Utilities	1.9%	2.4%	2.3%	1.7%	1.8%
Wholesale Trade	3.2%	2.2%	3.5%	0.6%	1.3%
Retail Trade	1.2%	2.1%	2.1%	2.5%	2.0%
Transportation, Warehousing and Utilities	1.9%	3.3%	1.0%	1.1%	2.0%
Information	2.5%	-0.2%	-0.1%	-0.2%	1.0%
Financial Activities	0.4%	-1.0%	0.9%	1.7%	1.6%
Professional and Business Services	4.0%	2.5%	1.6%	2.2%	1.6%
Educational and Health Services	6.7%	3.9%	2.7%	2.3%	2.5%
Leisure and Hospitality	5.8%	5.8%	4.5%	5.5%	5.0%
Other Services	2.8%	4.1%	2.0%	0.5%	0.9%
Government	-1.0%	1.0%	1.9%	1.6%	1.3%

Levels in millions

Personal Income

	2013	2014f	2015f	2016f	2017f
Personal Income	466.1	484.7	503.4	524.2	549.2
Annual percentage Change	2.3%	4.0%	3.9%	4.1%	4.8%
Per Capita Income ($)	$46,530	$48,083	$49,616	$51,321	$53,405

Taxable Sales

	2013	2014f	2015f	2016f	2017f
Total Taxable Sales	140.1	147.0	153.9	160.4	167.2
Year to Year Percentage Change	3.5%	4.9%	4.7%	4.3%	4.2%

TABLE 5 - RIVERSIDE/SAN BERNARDINO COUNTIES

Levels in thousands

Population

	2013	2014f	2015f	2016f	2017f
Total Population	4,440.9	4,540.8	4,641.6	4,743.3	4,845.7
Annual Percentage Change	2.3%	2.2%	2.2%	2.2%	2.2%

Household Employment

	2013	2014	2015f	2016f	2017f
Labor Force	1,897.0	1,919.9	1,945.4	1,978.3	2,008.8
Total Employment	1,710.5	1,763.3	1,814.0	1,854.1	1,895.3
Total Unemployment	186.5	156.6	128.7	125.1	124.1
Unemployment Rate	9.8%	8.2%	6.6%	6.3%	6.2%

Wage & Salary Employment

	2013	2014	2015f	2016f	2017f
Total Nonfarm	1,231.9	1,285.1	1,336.5	1,391.7	1,451.7
Goods Producing	158.6	168.5	178.4	192.5	207.8
Mining and Logging	1.2	1.3	1.2	1.2	1.3
Construction	70.0	77.0	84.0	92.0	101.9
Manufacturing	87.3	90.2	93.2	99.3	104.6
Durable Goods	57.3	59.8	61.5	65.4	69.7
Nondurable Goods	30.1	30.4	31.8	33.9	34.9
Service Providing	1,073.3	1,116.7	1,158.1	1,199.2	1,243.8
Trade, Transportation and Utilities	300.6	315.0	324.2	332.7	344.2
Wholesale Trade	56.4	59.0	61.6	60.8	62.7
Retail Trade	164.8	168.7	169.7	175.0	178.6
Transportation, Warehousing and Utilities	79.4	87.3	93.0	96.9	102.9
Information	11.5	11.2	11.2	10.8	11.0
Financial Activities	42.2	42.7	44.8	43.8	41.0
Professional and Business Services	132.4	137.8	151.0	158.0	164.0
Educational and Health Services	184.5	193.6	198.9	212.7	227.8
Leisure and Hospitality	135.9	144.3	152.4	160.1	168.3
Other Services	41.1	43.2	44.1	45.2	46.7
Government	225.2	228.8	231.6	236.0	240.9

Percentage change

	2013	2014	2015f	2016f	2017f
Total Nonfarm	4.4%	4.3%	4.0%	4.1%	4.3%
Goods Producing	5.3%	6.2%	5.9%	7.9%	8.0%
Mining and Logging	0.7%	6.3%	-6.7%	1.7%	5.9%
Construction	11.8%	9.9%	9.1%	9.5%	10.8%
Manufacturing	0.7%	3.3%	3.3%	6.5%	5.3%
Durable Goods	0.6%	4.4%	2.8%	6.4%	6.6%
Nondurable Goods	0.9%	1.2%	4.4%	6.7%	3.0%
Service Providing	4.2%	4.0%	3.7%	3.5%	3.7%
Trade, Transportation and Utilities	4.2%	4.8%	2.9%	2.6%	3.5%
Wholesale Trade	8.0%	4.6%	4.5%	-1.4%	3.2%
Retail Trade	1.5%	2.4%	0.5%	3.2%	2.1%
Transportation, Warehousing and Utilities	7.5%	9.9%	6.5%	4.2%	6.2%
Information	-1.6%	-2.7%	-0.6%	-3.2%	2.2%
Financial Activities	3.2%	1.3%	4.9%	-2.2%	-6.5%
Professional and Business Services	3.8%	4.1%	9.5%	4.7%	3.8%
Educational and Health Services	10.3%	5.0%	2.7%	6.9%	7.1%
Leisure and Hospitality	5.0%	6.2%	5.6%	5.1%	5.1%
Other Services	2.7%	5.0%	2.0%	2.5%	3.3%
Government	0.2%	1.6%	1.3%	1.9%	2.1%

Levels in millions

Personal Income

	2013	2014f	2015f	2016f	2017f
Personal Income	144.7	150.9	157.2	164.1	172.1
Annual Percentage Change	3.1%	4.3%	4.2%	4.3%	4.9%
Per Capita Income ($)	$32,578	$33,241	$33,872	$34,587	$35,507

Taxable Sales

	2013	2014f	2015f	2016f	2017f
Total Taxable Sales	61.2	64.5	67.8	71.5	75.4
Year to Year Percentage Change	6.3%	5.3%	5.2%	5.4%	5.5%

TABLE 6 - VENTURA COUNTY

Levels in thousands

Population

	2013	2014f	2015f	2016f	2017f
Total Population	839.6	849.1	858.7	868.4	878.1
Annual Percentage Change	0.6%	1.1%	1.1%	1.1%	1.1%

Household Employment

	2013	2014	2015f	2016f	2017f
Labor Force	434.3	431.6	433.3	440.3	445.6
Total Employment	400.1	402.7	406.9	411.9	416.4
Total Unemployment	34.2	28.8	24.6	23.1	22.6
Unemployment Rate	7.9%	6.7%	5.7%	5.3%	5.1%

Wage & Salary Employment

	2013	2014	2015f	2016f	2017f
Total Nonfarm	287.9	293.0	297.7	303.3	308.9
Goods Producing	43.8	45.6	45.6	48.9	52.2
Mining and Logging	1.2	1.3	1.2	1.0	1.5
Construction	12.6	13.7	14.7	16.8	18.3
Manufacturing	29.9	30.5	29.7	31.1	32.4
Durable Goods	18.2	18.5	18.2	18.7	19.5
Nondurable Goods	11.8	12.0	11.5	12.4	12.8
Service Providing	244.1	247.4	252.1	254.4	256.7
Trade, Transportation and Utilities	57.2	58.1	59.2	60.7	61.6
Wholesale Trade	12.9	13.0	13.1	14.5	15.4
Retail Trade	38.5	39.0	39.8	40.9	40.7
Transportation, Warehousing and Utilities	5.9	6.2	6.3	5.3	5.5
Information	5.2	5.5	5.6	4.6	5.5
Financial Activities	18.9	18.7	18.5	16.6	15.7
Professional and Business Services	36.3	35.5	37.2	37.3	37.1
Educational and Health Services	39.5	41.0	41.3	44.9	44.2
Leisure and Hospitality	33.8	35.0	36.0	38.9	40.3
Other Services	9.7	9.9	9.9	10.0	10.0
Government	43.6	43.8	44.5	41.3	42.2

Percentage change

	2013	2014	2015f	2016f	2017f
Total Nonfarm	2.2%	1.8%	1.6%	1.9%	1.8%
Goods Producing	1.9%	4.1%	0.1%	7.2%	6.6%
Mining and Logging	-3.9%	6.8%	-7.3%	-13.6%	40.6%
Construction	6.9%	9.0%	7.1%	14.0%	9.3%
Manufacturing	0.1%	1.9%	-2.7%	4.7%	4.1%
Durable Goods	-0.3%	1.9%	-1.7%	2.7%	4.5%
Nondurable Goods	0.9%	2.0%	-4.2%	8.0%	3.3%
Service Providing	2.3%	1.4%	1.9%	0.9%	0.9%
Trade, Transportation and Utilities	2.8%	1.5%	2.0%	2.5%	1.4%
Wholesale Trade	2.0%	0.8%	1.4%	10.4%	6.3%
Retail Trade	3.2%	1.1%	2.2%	2.8%	-0.6%
Transportation, Warehousing and Utilities	2.2%	5.4%	2.2%	-15.5%	3.7%
Information	1.1%	5.0%	1.7%	-16.6%	19.5%
Financial Activities	-3.5%	-1.0%	-1.4%	-9.9%	-5.7%
Professional and Business Services	3.9%	-2.1%	4.7%	0.3%	-0.4%
Educational and Health Services	5.3%	3.8%	0.9%	8.6%	-1.5%
Leisure and Hospitality	3.0%	3.7%	2.7%	8.2%	3.6%
Other Services	2.7%	2.2%	0.2%	1.0%	0.3%
Government	0.0%	0.4%	1.5%	-7.2%	2.2%

Levels in millions

Personal Income

	2013	2014f	2015f	2016f	2017f
Personal Income	42.4	44.3	46.3	48.4	50.9
Annual Percentage Change	1.7%	4.5%	4.3%	4.6%	5.2%
Per Capita Income ($)	$50,507	$52,214	$53,870	$55,701	$57,954

Taxable Sales

	2013	2014f	2015f	2016f	2017f
Total Taxable Sales	12.8	13.3	14.1	14.9	15.6
Year to Year Percentage Change	7.2%	4.1%	5.8%	5.7%	4.6%

TABLE 7 - IMPERIAL COUNTY

Levels in thousands

Population

	2013	2014f	2015f	2016f	2017f
Total Population	176.6	180.9	185.2	189.5	193.8
Annual Percentage Change	-0.1%	2.4%	2.4%	2.3%	2.3%

Household Employment

	2013	2014	2015f	2016f	2017f
Labor Force	78.8	80.3	80.9	82.5	84.2
Total Employment	59.1	61.3	61.6	64.3	66.1
Total Unemployment	19.6	19.0	19.7	19.9	20.1
Unemployment Rate	24.9%	23.6%	24.4%	24.1%	23.8%

Wage & Salary Employment

	2013	2014	2015f	2016f	2017f
Total Nonfarm	51.4	53.7	53.4	54.6	55.8
Goods Producing	4.5	4.1	4.4	3.3	3.2
Mining, Logging, and Construction	2.0	2.4	2.4	2.3	2.1
Construction					
Manufacturing	2.5	1.7	2.0	1.0	1.0
Durable Goods	0.5	0.6	0.6	0.6	0.6
Nondurable Goods	2.0	1.1	1.5	0.4	0.4
Service Providing	46.9	49.7	49.0	51.2	52.7
Trade, Transportation and Utilities	12.1	13.4	13.1	14.2	14.5
Wholesale Trade	1.8	1.8	1.8	1.8	1.8
Retail Trade	8.4	9.5	9.4	9.9	10.2
Transportation, Warehousing and Utilities	2.0	2.1	2.0	2.4	2.5
Information	0.3	0.3	0.3	0.3	0.4
Financial Activities	1.4	1.4	1.4	1.4	1.4
Professional and Business Services	2.8	2.8	2.9	2.5	2.5
Educational and Health Services	7.9	9.1	8.7	9.7	10.2
Leisure and Hospitality	3.9	4.1	4.1	4.1	4.1
Other Services	0.8	0.8	0.8	0.9	0.9
Government	17.7	17.9	17.7	18.2	18.7

Percentage change

	2013	2014	2015f	2016f	2017f
Total Nonfarm	4.7%	4.5%	-0.6%	2.1%	2.3%
Goods Producing	8.0%	-10.1%	8.9%	-24.4%	-5.5%
Mining, Logging, and Construction	31.4%	16.9%	0.4%	-1.1%	-8.8%
Construction					
Manufacturing	-5.7%	-32.1%	20.7%	-51.5%	2.3%
Durable Goods	3.3%	6.3%	0.7%	-2.0%	4.9%
Nondurable Goods	-7.8%	-42.4%	30.6%	-70.3%	-1.0%
Service Providing	4.4%	5.9%	-1.3%	4.5%	2.8%
Trade, Transportation and Utilities	7.9%	10.5%	-2.0%	7.7%	2.7%
Wholesale Trade	4.3%	-0.9%	-0.4%	1.1%	-0.6%
Retail Trade	8.5%	14.0%	-1.4%	5.9%	2.6%
Transportation, Warehousing and Utilities	8.2%	6.3%	-6.1%	22.4%	5.4%
Information	-21.3%	-2.7%	-2.7%	8.3%	16.2%
Financial Activities	4.3%	-0.6%	-0.2%	0.6%	-0.3%
Professional and Business Services	0.0%	0.3%	5.5%	-15.5%	2.2%
Educational and Health Services	16.0%	14.2%	-3.5%	11.0%	5.0%
Leisure and Hospitality	6.9%	5.4%	-0.3%	1.0%	-0.7%
Other Services	0.0%	2.1%	-5.1%	16.0%	1.4%
Government	-1.2%	0.8%	-0.9%	2.8%	2.8%

Levels in millions

Personal Income

	2013	2014f	2015f	2016f	2017f
Personal Income	5.7	5.9	6.1	6.4	6.7
Annual percentage change	3.6%	4.0%	3.9%	4.1%	4.6%
Per capita income ($)	$32,225	$32,717	$33,196	$33,759	$34,508

Taxable Sales

	2013	2014f	2015f	2016f	2017f
Total Taxable Sales	3.7	4.1	4.1	4.3	4.5
Year to Year Percentage Change	55.4%	11.3%	1.1%	5.4%	3.1%

TABLE 8 - CONSTRUCTION AND REAL ESTATE ('000)

Orange County

	2013	2014	2015f	2016f	2017f
Permits	9.9	9.8	10.2	10.7	11.3
Residential Valuation	2,506.3	2,413.7	2,939.0	3,244.6	3,484.7
Non-Residential Valuation	1,518.4	1,956.5	1,575.3	1,750.2	1,855.2
Percentage change					
Permits	44.9%	-1.5%	4.2%	5.2%	5.6%
Residential Valuation	53.6%	-3.7%	21.8%	10.4%	7.4%
Non-Residential Valuation	20.4%	28.9%	-19.5%	11.1%	6.0%

Los Angeles County

	2013	2014	2015f	2016f	2017f
Permits	16.3	18.9	23.0	26.3	28.5
Residential Valuation	4,670.8	5,479.8	6,172.7	6,740.6	7,374.2
Non-Residential Valuation	4,135.1	6,730.5	8,305.5	9,451.6	10,585.8
Percentage change					
Permits	52.0%	15.9%	22.0%	14.1%	8.3%
Residential Valuation	40.8%	17.3%	12.6%	9.2%	9.4%
Non-Residential Valuation	110.5%	62.8%	23.4%	13.8%	12.0%

Riverside/San Bernardino Counties

	2013	2014	2015f	2016f	2017f
Permits	9.2	9.8	9.2	9.0	9.4
Residential Valuation	1,960.0	2,182.7	2,148.8	2,111.3	2,165.6
Non-Residential Valuation	1,588.8	1,634.1	1,612.1	1,532.1	1,587.9
Percentage change					
Permits	51.6%	6.4%	13.0%	17.3%	22.3%
Residential Valuation	29.5%	11.4%	-1.6%	-1.7%	2.6%
Non-Residential Valuation	49.7%	2.9%	-1.4%	-5.0%	3.6%

Ventura County

	2013	2014	2015f	2016f	2017f
Permits	0.7	1.0	0.8	0.8	0.8
Residential Valuation	246.1	311.5	269.9	269.0	301.1
Non-Residential Valuation	136.1	132.9	135.8	162.1	163.9
Percentage change					
Permits	78.3%	31.2%	14.6%	6.3%	5.9%
Residential Valuation	66.0%	26.6%	14.6%	5.4%	11.9%
Non-Residential Valuation	34.4%	-2.4%	5.8%	19.3%	1.1%

Imperial County

	2013	2014	2015f	2016f	2017f
Permits	0.3	0.2	0.3	0.3	0.2
Residential Valuation	71.8	46.9	54.5	65.4	62.4
Non-Residential Valuation	590.0	34.8	38.8	83.8	95.2
Percentage change					
Permits	-4.0%	-29.3%	25.9%	-5.7%	-10.8%
Residential Valuation	30.6%	-34.7%	16.2%	20.0%	-4.6%
Non-Residential Valuation	8.2%	-94.1%	11.4%	16.1%	13.7%

Southern California

	2013	2014	2015f	2016f	2017f
Permits	36.5	39.6	43.5	47.1	50.2
Residential Valuation	9,455.0	10,434.6	11,584.9	12,430.9	13,388.1
Non-Residential Valuation	7,968.4	10,488.8	11,667.4	12,979.8	14,288.0
Percentage change					
Permits	49.6%	8.7%	9.9%	8.1%	6.7%
Residential Valuation	41.8%	10.4%	11.0%	7.3%	7.7%
Non-Residential Valuation	61.5%	31.6%	11.2%	11.2%	10.1%

Sources: Number of housing permits and valuation data, in thousands, are from CCR

SOUTHERN CALIFORNIA LEADING ECONOMIC INDICATOR

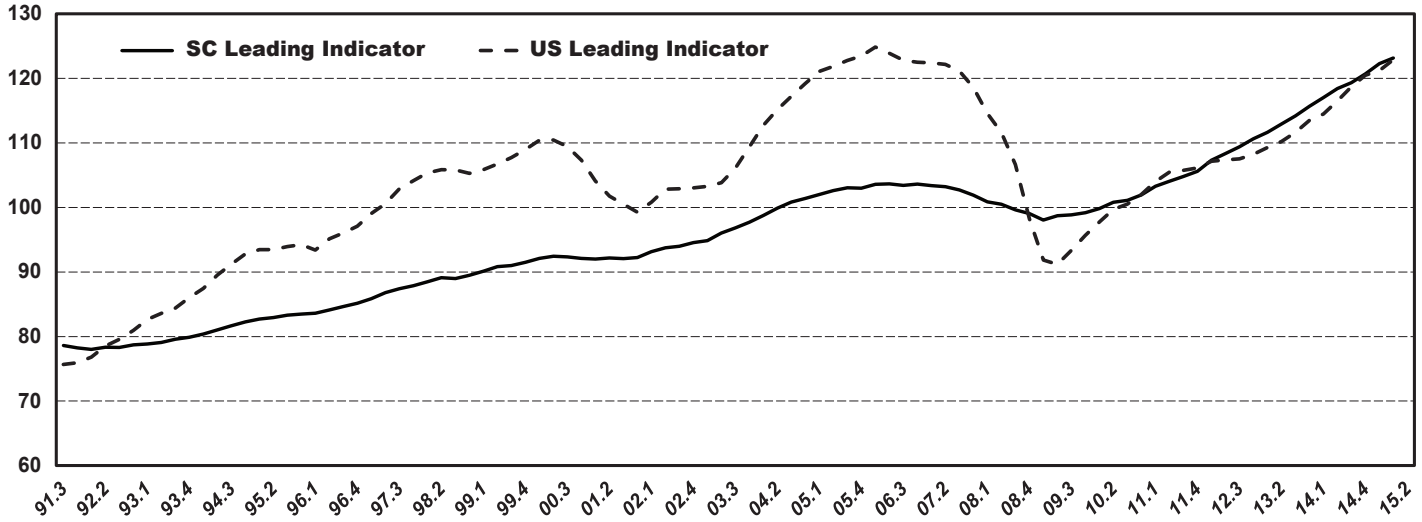
Adrian R. Fleissig, Ph.D.

Research Associate, Woods Center for Economic Analysis and Forecasting
Professor, Department of Economics, Mihaylo College of Business and Economics, CSUF

SUMMARY

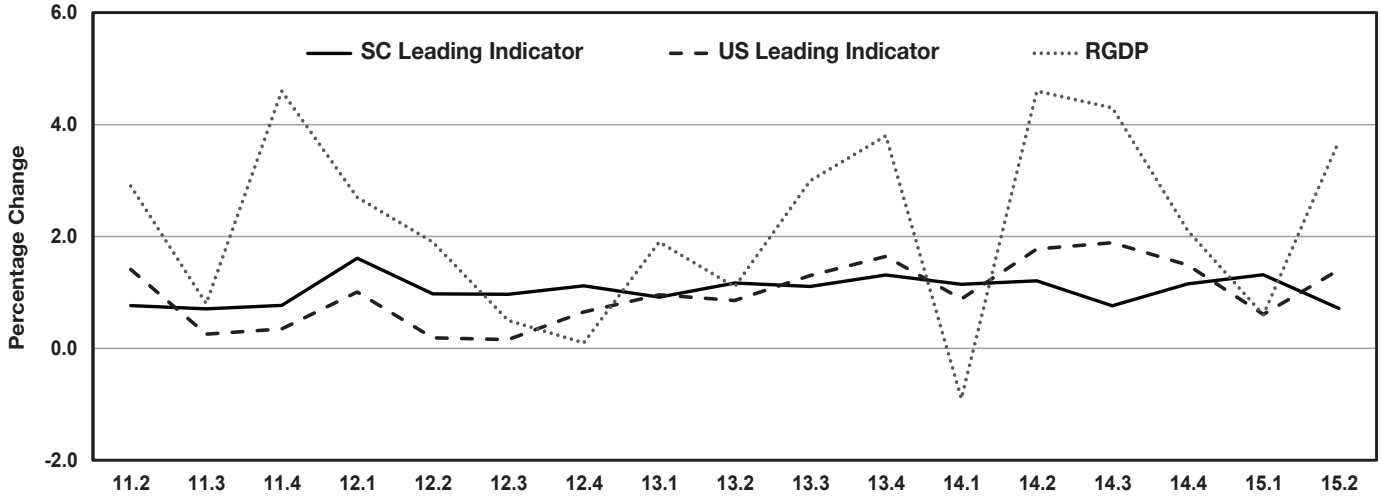
The Southern California Leading Economic Indicator increased by 0.71% in the second quarter of 2015 compared to the first quarter of 2015. This increase suggests a pickup in economic activity in the Southern California region in the next three to six months. The SC Leading Indicator continues on its upward trend and has now increased for seven years since the last decrease in the third quarter of 2009. The US leading economic indicator increased in the second quarter of 2015 and implies an increase in economic activity for the US economy in the next three to six months (Figure 1).

FIGURE 1
Southern California and U.S. Leading Indicators



US economic activity, often measured by real GDP growth, is expected to increase in the next three to six months, given the increase in the US leading indicator. The rise in the SC Leading Indicator suggests a rise in economic activity in Southern California (Figure 2).

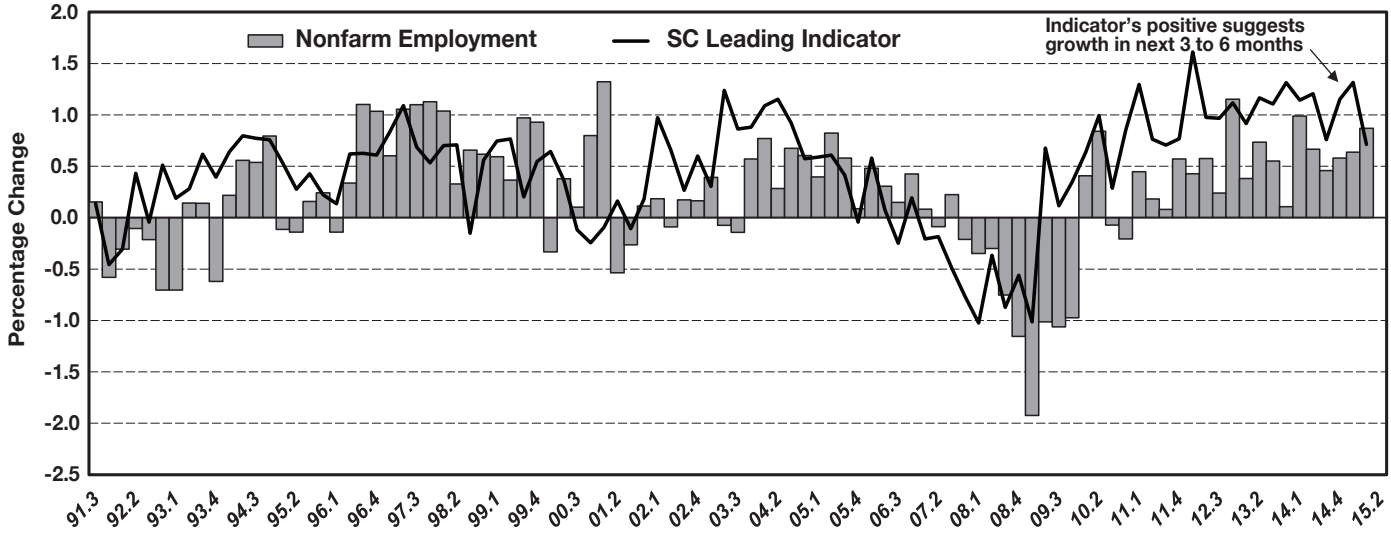
FIGURE 2
Leading Indicators and Real GDP



Southern California Indicator and Economic Activity

In the absence of up-to-date gross state product data for Southern California, our index is used to analyze trends in total civilian employment. The indicator has been found to be a good predictor of regional economic trends. In general, changes in the index take place prior to changes in regional economic activity. For example, during the recessions of the early 1990s, 2001 and late 2007-2008, the Southern California leading indicator decreased significantly (Figure 3).

FIGURE 3
Southern California Leading Indicator and Employment



Changes in the Woods Center for Economic Analysis and Forecasting's Leading Indicator and Its Components

The Southern California Leading Indicator increased from a value of 122.27 in the first quarter of 2015 to a value of 123.14 in the second quarter of 2015. The SC Leading Indicator has now increased for seven years since the decline in the third quarter of 2009. The 0.71% increase in the second quarter of 2015 suggests continued growth in economic activity in the Southern California region in the next 3 to 6 months. Civilian employment in Southern California, which is notoriously erratic, subject to measurement errors and continually revised, showed an increase in the second quarter of 2015 of 0.87%.

TABLE 1
Leading Economic Indicators and Total Civilian Employment

Variable	2014.2	2014.3	2014.4	2015.1	2015.2
SC Indicator	118.41	119.31	120.69	122.27	123.14
% Change	1.21	0.76	1.15	1.32	0.71
U.S. Indicatvor	116.50	118.70	120.47	121.20	122.90
% Change	1.78	1.89	1.49	0.61	1.40
Civilian Employment	8,309,907	8,347,931	8,396,368	8,449,795	8,523,344
% Change	0.67	0.46	0.58	0.64	0.87

Economic Conditions

For the US economy, real gross domestic product increased at an annualized growth rate of 3.7% during the second quarter of 2015, following the 0.6% increase in the first quarter of 2015. US inflation, measured by the consumer price index, increased by 0.1% in July 2015 and follows the 0.3% increase in June 2015. For California, the seasonally adjusted unemployment rate for July 2015 was 6.2%, which is lower than the 6.3% of June 2015 and higher than the US unemployment rate of 5.3% in July 2015. Payroll employment in California increased in July 2015 compared to the previous month. There were jobs gains in the nine categories of construction; manufacturing; trade, transportation and utilities; information; financial activities; professional and business services; educational and health services; leisure and hospitality; and other services. There were job losses in the two categories of mining and logging and government.

HOW HAPPY ARE PEOPLE IN ORANGE COUNTY?

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Does money buy happiness? A recent study suggests that it can. Economists in the United Kingdom recently found that people's happiness is more strongly related to their wealth, not their income[1]. Among the different types of wealth that people have, happiness is most closely related to their net financial wealth, which is their wealth held in cash, stocks, bonds, and their other financial assets net of any liabilities that they have. Housing wealth and pension wealth were not related to happiness once the economists controlled for other forms of wealth, income, and other demographic factors.

The results of the study suggest that one of the best ways to study the happiness of people across Orange County is to study their financial wealth. The challenge of examining the distribution of financial wealth across Orange County is paucity of data on individuals' wealth. While we cannot observe how wealthy people are, we can observe how their financial wealth grows by tracking their interest and dividend income. The Internal Revenue Service (IRS) publicly provides such income tax data.

Figure 1 displays the percentile rank of ZIP codes in Orange County among all US ZIP codes by our proxy of net financial wealth. The percentile rank of a ZIP code indicates the percentage of all ZIP codes with average interest plus dividend income below the ZIP code examined. A ZIP code at the 90th percentile has average interest plus dividend income that is above 90% of all ZIP codes in the United States. The dollar value in parentheses next to the percentile ranks in the legend of the map indicates the average interest plus dividend income at that percentile among US ZIP codes. For example, a ZIP code with an average of $127 interest and dividend income per return would rank at the 10th percentile of US ZIP codes.

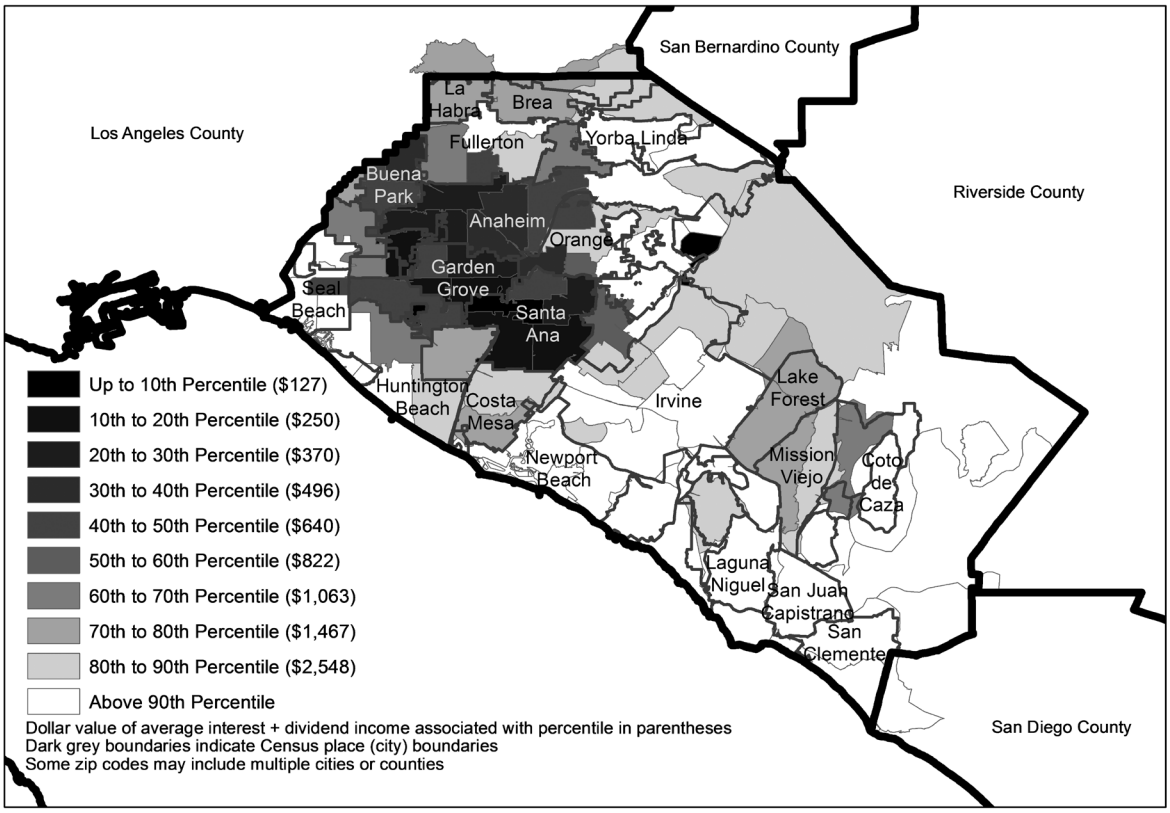
This map shows the disparity in average financial wealth by ZIP code in Orange County. Aside from ZIP code 92862, which has no residents, the poorest ZIP code in Orange County is 92703 in Santa Ana with an average of $66 of dividend and interest income reported per return. It is among the poorest 10% of ZIP codes in the United States by this measure. The richest ZIP code in Orange County is 92657 in Newport Coast with an average of $44,355 of interest and dividend income per return, which ranks in the top 0.2% of ZIP codes.

Elsewhere in Orange County, financial wealth is highest along the coast, in the southeastern part of the county, and to the east of State Route 55 from Irvine to Yorba Linda. Most of these areas rank in the top 10-20% of US ZIP codes by financial wealth. ZIP codes in the northwestern part of the county, including Anaheim, Garden Grove, Santa Ana, and Stanton, consistently rank in the bottom 25% of ZIP codes by financial wealth.

What explains the low financial wealth in northwestern Orange County? First, housing prices and the cost of living are high in Orange County, which may cause people to divert income that would otherwise be saved or invested to rent, housing, and living expenses. In Santa Ana, while median

[1] "Relationship between Wealth, Income and Personal Well-being, July 2011 to June 2012" by the Office for National Statistics.

FIGURE 1
Percentile Rank of Orange County Zip Codes by Estimated Financial Wealth



household income ($53,335) is similar to median household income for the nation as a whole ($53,046)[2], median home sale prices are over twice as much in Santa Ana ($463,000)[3] compared to the national median ($228,700)[4]. Overall, the cost of living is about 47% higher in Orange County compared to the national average[5].

Second, relatively few tax returns report interest and dividend income according to the IRS data. While 64% of returns have interest income and 53% have dividend income in the richest ZIP code (92657), only 13% of returns have interest income and 2% have dividend income in the poorest ZIP code (92703). Many people struggle to pay their living expenses and consequently have little savings.

Third, people with families living abroad may remit much of their income that would otherwise go to their savings. The remitted income would not be invested in the United States and would not show up as interest or dividend income in the IRS data. This third explanation is important in our analysis, because it suggests that we may underestimate average financial wealth in areas with large Hispanic and Asian populations and consequently underestimate their happiness.

Nevertheless, we find a significant disparity of wealth across Orange County. Richer areas of Orange County along the coast, in the south, and in the east have more financial wealth and would expected to be happier on average than in northwestern parts of Orange County.

[2] According to American Community Survey 5-year estimates as of 2013.
[3] According to Core Logic as of August 2015.
[4] According to the National Association of Realtors as of August 2015.
[5] According to the Cost of Living Index published by The Council for Community and Economic Research as of the 2nd quarter of 2014.



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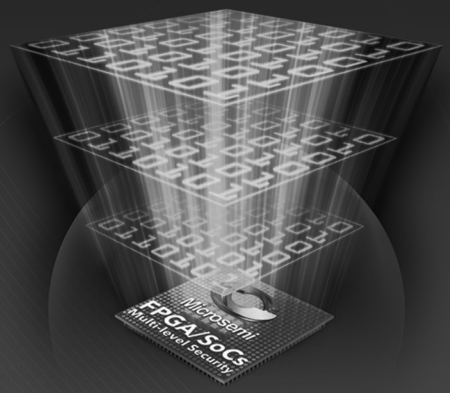
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